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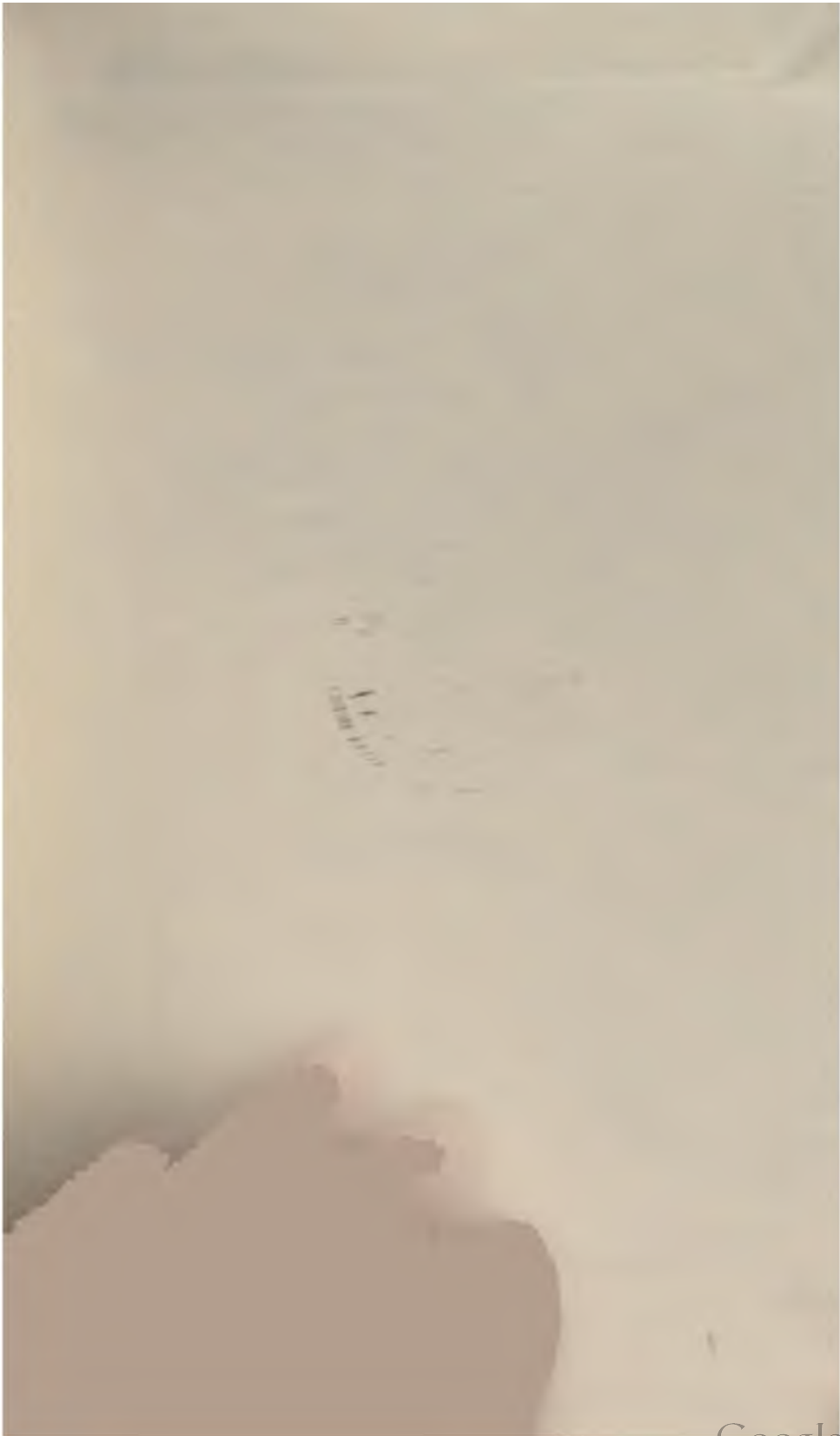
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**RURAL ELECTRIFICATION AND TELEPHONE
REVOLVING FUND SELF-SUFFICIENCY ACT OF 1983**

CIS RECORD ONLY:

HEARINGS
BEFORE THE
SUBCOMMITTEE ON CONSERVATION, CREDIT,
AND RURAL DEVELOPMENT
OF THE
COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES
NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

H.R. 3050

OCTOBER 4 AND 5, 1983

Serial No. 98-37



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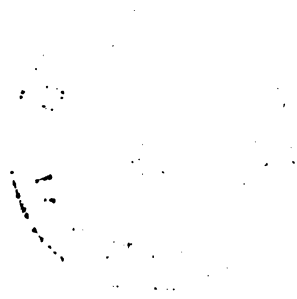
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RURAL ELECTRIFICATION AND TELEPHONE REVOLVING FUND SELF-SUFFICIENCY ACT OF 1983

TUESDAY, OCTOBER 4, 1983

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSERVATION, CREDIT,
AND RURAL DEVELOPMENT,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 1302, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Weaver, Bedell, English, Stenholm, Tallon, Durbin, Evans of Illinois, Coleman, Skeen, Morrison, and Gunderson.

Also present: Representative de la Garza, chairman of the full committee. Representatives Penny and Stangeland of the full committee and Representatives Ridge, Derrick, Clinger, Bevill, and Tauzin.

Staff present: Robert M. Bor, chief counsel; Robert T. Lowerre, associate counsel; John E. Hogan, minority counsel; Mark Dungan, minority associate counsel; Peggy L. Pecore, clerk; Robert A. Cashdollar, James W. Johnson, Jr., Gerald W. Welcome, Bernard Brenner, and Davis A. Ebersole.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. JONES of Tennessee. The Subcommittee on Conservation, Credit, and Rural Development will come to order.

Before we begin to hear the first witness, I, as chairman of the subcommittee, have a statement I would like to make. I will also give the other members of the subcommittee a chance to make whatever statement they would like.

Ladies and gentlemen, we are meeting today for the purpose of gathering testimony on H.R. 3050, the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983. As you all know, I introduced this legislation back in May, and as of today there are now 167 cosponsors in the House.

H.R. 3050 is unlike most bills we consider in this committee in one very important respect. It addresses a problem that everyone recognizes is in the making, yet we are attempting to deal with the problem before it becomes a crisis. I want to take this opportunity to go on record in noting my gratitude to both the electric and to

the telephone program borrowers and the Department of Agriculture for their foresight and for their sense of responsibility in beginning to address the depletion of the Revolving Fund before it takes everyone by surprise.

By making some very fundamental changes in the financing program created under the Rural Electrification Act of 1936, H.R. 3050 will insure the ability of America's rural electric and telephone systems to continue the job they set out to do nearly a half century ago: to provide adequate, reliable, and affordably priced electric and telephone service to the consumers of rural America.

In basic terms, what we are attempting to accomplish through this bill is to provide long-term strength and stability to the Revolving Fund. This Revolving Fund is the mechanism which Congress created in 1973 to serve as the source of capital for REA-insured loans to rural electric and telephone systems.

Every major segment of the rural electric and telephone program has expressed support for the basic thrust of this legislation. While the bill does not solve every single problem and concern of the REA borrower community, it does, I believe, address in an adequate and forthright way the key issues which must be faced if rural America and the Nation as a whole are to continue to benefit from a strong rural electric and telephone program.

A summary of H.R. 3050 has been placed at each Member's desk, and I will not go into detail about the bill's provisions at this time. We have a good many witnesses scheduled during these 2 days, and I can see we will need to move rapidly in order to hear everyone who wishes to testify.

For the sake of time, I request that whenever possible, witnesses submit printed statements for the official hearing record and then briefly summarize your testimony. I can assure you that if you summarize, your entire statement will be reviewed, but we need to move along so there will be time to ask questions. We will also be under the 5-minute rule during questioning of witnesses, and if time permits we can go back to a second round of questioning.

[H.R. 3050 and the report from U.S. Department of the Treasury follow:]

98TH CONGRESS
1ST SESSION

H. R. 3050

To amend the Rural Electrification Act of 1936 to ensure the continued financial integrity of the Rural Electrification and Telephone Revolving Fund, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MAY 18, 1983

Mr. JONES of Tennessee (for himself, Mr. COLEMAN of Missouri, Mr. DE LA GARZA, Mr. MARLENEE, Mr. ALBOSTA, Mr. ALEXANDER, Mr. ANTHONY, Mr. BARNARD, Mr. BEDELL, Mr. BEVILL, Mr. BONER of Tennessee, Mr. BONIOR of Michigan, Mr. BOUCHER, Mr. BREAUX, Mr. BRITT, Mr. BROWN of California, Mr. BROWN of Colorado, Mr. BROYHILL, Mr. CABE, Mr. CHAPPELL, Mr. CLARKE, Mr. CLAY, Mr. COELHO, Mr. COOPER, Mr. CORCOBAN, Mr. DASCHLE, Mr. DERRICK, Mr. DUNCAN, Mr. DURBIN, Mr. EMBERSON, Mr. ENGLISH, Mr. EVANS of Illinois, Mr. FOLEY, Mr. FORD of Tennessee, Mr. FUQUA, Mr. GAYDOS, Mr. GEPHARDT, Mr. GINGRICH, Mr. GOBE, Mr. GUNDERSON, Mr. HANCE, Mr. HARKIN, Mr. HARTNETT, Mr. HATCHER, Mr. HEFNER, Mr. HIGHTOWER, Mr. HILLIS, Mr. HUBBAED, Mr. HUCKABY, Mr. JENKINS, Mr. JONES of North Carolina, Ms. KAPTUR, Mr. KINDNESS, Mr. KOLTER, Mr. LEACH of Iowa, Mr. LEATH of Texas, Mr. LEHMAN of Florida, Mrs. LLOYD, Mr. MCCURDY, Mr. MCHUGH, Mr. McNULTY, Mr. MADIGAN, Mr. MOLLOHAN, Mr. MONTGOMERY, Mr. MORRISON of Washington, Mr. MURPHY, Mr. MURTHA, Mr. NICHOLS, Mr. OBERSTAR, Mr. ORTIZ, Mr. PEASE, Mr. PENNY, Mr. PERKINS, Mr. QUILLEN, Mr. RAHALL, Mr. RATCHFORD, Mr. RICHARDSON, Mr. ROBERTS, Mr. ROE, Mr. ROSE, Mr. ROWLAND, Mr. SABO, Mr. SIKORSKI, Mr. SIMON, Mr. SKELTON, Mr. SMITH of Iowa, Mr. SPENCE, Mr. SPRATT, Mr. STANGELAND, Mr. STENHOLM, Mr. SUNDQUIST, Mr. TALLON, Mr. TAUKE, Mr. TAUZIN, Mr. TAYLOR, Mr. THOMAS of Georgia, Mr. TRAXLEE, Mr. UDALL, Mr. VANDERGRIF, Mr. VANDEE JAGT, Mr. VENTO, Mr. VOLKMEER, Mr. WATKINS, Mr. WEAVER, Mr. WEBER, Mr. WHEAT, Mr. WHITLEY, Mr. WILLIAMS of Montana, Mr. WILSON, Mr. WINN, Mr. WOLFE, and Mr. YOUNG of Missouri) introduced the following bill; which was referred to the Committee on Agriculture

A BILL

To amend the Rural Electrification Act of 1936 to ensure the continued financial integrity of the Rural Electrification and Telephone Revolving Fund, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the “Rural Electrification and
4 Telephone Revolving Fund Self-Sufficiency Act of 1983”.

5 SEC. 2. Section 201 of the Rural Electrification Act of
6 1936 (7 U.S.C. 922) is amended by striking out the last two
7 sentences and inserting in lieu thereof the following: “Loans
8 under this section shall not be made unless the Administrator
9 finds and certifies that, in the Administrator’s judgment, the
10 security therefor is reasonably adequate and such loan will be
11 repaid within the time agreed.”.

12 SEC. 3. Section 203 of the Rural Electrification Act of
13 1936 (7 U.S.C. 924) is amended to read as follows:

14 “SEC. 203. (a) As used in this title, the term ‘telephone
15 service’ shall be deemed to mean any communication service
16 for the transmission of voice, data, sounds, signals, pictures,
17 writing, or signs of all kinds by wire, fiber, radio, light, or
18 other visual or electromagnetic means, and shall include all
19 lines, facilities, or systems used in the rendition of such serv-
20 ice; but shall not be deemed to mean message telegram serv-
21 ice or community antenna television system services or

1 facilities other than those intended exclusively for educational
2 purposes, or radio broadcasting services or facilities within
3 the meaning of section 3(o) of the Communications Act of
4 1934, as amended.

5 “(b) As used in this title, the term ‘rural area’ shall be
6 deemed to mean any area of the United States not included
7 within the boundaries of any incorporated or unincorporated
8 city, village, or borough having a population in excess of two
9 thousand five hundred inhabitants.”.

10 SEC. 4. Section 302 of the Rural Electrification Act of
11 1936 (7 U.S.C. 932) is amended by—

12 (1) in subsection (a), inserting “shall be equity
13 capital of the fund” immediately after “Act”;

14 (2) amending clause (2) of subsection (b) to read
15 as follows:

16 “(2) payment of principal and interest on loans to
17 the Administrator from the Secretary of the Treasury
18 under section 304(a) of this title and on certificates of
19 beneficial ownership issued to the Secretary of the
20 Treasury or in the private market under section 304(c)
21 of this title;” and

22 (3) adding at the end thereof a new subsection (c)
23 as follows:

24 “(c) The Administrator shall maintain two separate ac-
25 counts within the fund, to be known as the Electrification

1 Account and the Telephone Account, respectively. The
2 assets, liabilities, income, expenses, and equity of the fund
3 described in section 301 of this Act and subsection (a) of this
4 section that are attributable to the operations of the electric
5 loan program shall be accounted for in the Electrification Ac-
6 count and the assets, liabilities, income, expenses, and equity
7 of the fund so described that are attributable to the oper-
8 ations of the telephone loan program shall be accounted for in
9 the Telephone Account. The assets accounted for in the
10 Electrification Account shall be available only for the pur-
11 poses described in subsection (b) of this section relating to the
12 operations of the electric loan program, and the assets ac-
13 counted for in the Telephone Account shall be available only
14 for the purposes described in subsection (b) of this section
15 relating to the operations of the telephone loan program.”.

16 SEC. 5. Section 304 of the Rural Electrification Act of
17 1936 (7 U.S.C. 934) is amended by adding a new sentence at
18 the end of subsection (c) as follows: “Whenever the interest
19 rate on any certificate of beneficial ownership that has a re-
20 maining term of seven years or more and that is issued by the
21 Administrator and purchased under this subsection exceeds
22 the rate of interest applicable to other similar certificates
23 then being purchased by one hundred basis points (1 per
24 centum) or more, the Administrator is authorized to repur-

1 chase the certificate. Such repurchase shall be made without
2 penalty.”.

3 SEC. 6. Section 305 of the Rural Electrification Act of
4 1936 (7 U.S.C. 935) is amended by—

5 (1) amending subsection (b) to read as follows:

6 “(b) Insured loans made under this title from each ac-
7 count in the fund shall bear interest at a rate (hereinafter in
8 this section referred to as the ‘standard rate’) that shall be
9 established by the Administrator and adjusted thereafter from
10 time to time, under rules and regulations to be promulgated
11 within one hundred and twenty days after the effective date
12 of the Rural Electrification and Telephone Revolving Fund
13 Self-Sufficiency Act of 1983. Such rules and regulations shall
14 provide that the standard rate for each account shall be that
15 rate, not less than 5 per centum per annum, that would pro-
16 duce, from loans (other than special rate loans) approved
17 from that account during a given period, interest income
18 equal to, but not greater than, the amount of anticipated in-
19 terest expense on the account’s obligations (interim notes,
20 insured notes, and certificates of beneficial ownership) re-
21 quired to be issued or sold during such period to cover loan
22 advances and interest expenses: *Provided*, That the amount
23 of such obligations to be issued or sold for such purposes shall
24 be determined by deducting the sum of principal and interest
25 receipts and any appropriation under subsection (c) of this

1 section from the sum of loan advances and interest expenses
2 on outstanding obligations of the account during such period.
3 The standard rate, as established by the Administrator, and
4 any adjustment thereto shall be made having due regard for
5 the objectives of this Act and shall be applicable only to loans
6 made after the effective date of such establishment or adjust-
7 ment. The Administrator may make insured loans to electric
8 or telephone borrowers at a lesser interstate rate, but not less
9 than 2 per centum per annum nor more than a rate equal to
10 one-half the standard rate (hereinafter in this section referred
11 to as the 'special rate') if the Administrator finds, under
12 guidelines to be established within one hundred and twenty
13 days after the effective date of the Rural Electrification and
14 Telephone Revolving Fund Self-Sufficiency Act of 1983, that
15 the borrower—

16 “(1)(A) charges rates exceeding twice the national
17 average of rates charged by borrowers in the same
18 program, or cannot provide service consistent with the
19 objectives of this Act without charging rates (estab-
20 lished in accordance with generally accepted manage-
21 ment and accounting principles) so high as to create a
22 substantial disparity between such rates and the rates
23 charged for similar service in the same or nearby areas
24 by other suppliers; or

1 “(B) has an average consumer density of two or
2 fewer per mile of line; or

3 “(C) has experienced financial losses attributable
4 to storm damage, natural disasters, or other occur-
5 rences beyond its control; or

6 “(D) serves geographic areas having unusually
7 low per capita income; and

8 “(2) is experiencing financial or other hardship
9 through extenuating circumstances.

10 The rules and regulations promulgated under this subsection
11 shall not take effect until (1) such rules and regulations have
12 been transmitted to the Senate Committee on Agriculture,
13 Nutrition, and Forestry and the House Committee on Agri-
14 culture and (2) the expiration of thirty calendar days of con-
15 tinuous session of Congress after the date of such transmit-
16 tal.”;

17 (2) redesignating subsection (c) as subsection (d),
18 and in subsection (d), as so redesignated, striking out
19 “; such loans shall be sold and insured by the Adminis-
20 trator without undue delay”; and

21 (3) inserting, after subsection (b), a new subsec-
22 tion (c) as follows:

23 “(c) The Secretary of Agriculture shall include in each
24 annual supplemental budget estimate or request submitted to
25 the President or the Office of Management and Budget, and

1 shall concurrently submit to the House Committee on Approp-
2 priations, the Senate Committee on Appropriations, the
3 House Committee on Agriculture, and the Senate Committee
4 on Agriculture, Nutrition, and Forestry, a request for the
5 amount of funds determined by the Administrator to be nec-
6 essary to replenish the fund for all actual and anticipated
7 costs to the fund resulting from loans made at less than the
8 standard rate during the preceding fiscal year.”.

9 SEC. 7. Section 306 of the Rural Electrification Act of
10 1936 (7 U.S.C. 1936) is amended by—

11 (1) inserting “(a)” immediately after the section
12 designation;

13 (2) striking out the first sentence and inserting in
14 lieu thereof the following: “For the purposes of (1) en-
15 couraging and assisting borrowers to develop and
16 achieve the financial strength necessary to satisfy their
17 credit needs from other sources and (2) improving the
18 financial stability of borrowers, the Administrator, con-
19 sistent with the objectives of this Act and in accord-
20 ance with the rules and regulations to be promulgated
21 under subsection (b) of this section, shall provide finan-
22 cial assistance to borrowers for purposes provided in
23 this Act and for purposes of providing refinancing as-
24 sistance, by guaranteeing loans, in the full amount
25 thereof, made by the Rural Telephone Bank, the Na-

1 tional Rural Utilities Cooperative Finance Corporation,
2 and any other legally organized lending agency or
3 lender approved by the Administrator, or by accommo-
4 dating or subordinating liens or mortgages in the fund
5 held by the Administrator as owner or as trustee or
6 custodian for purchases of notes from the fund, or by
7 any combination of such guarantee, accommodation, or
8 subordination. The Administrator shall accommodate or
9 subordinate liens or mortgages at the request of the
10 borrower, notwithstanding any other provision of this
11 Act, for any purpose that would enhance the financial
12 strength or revenue of the borrower or improve the ef-
13 ficiency, effectiveness, or financial stability of the bor-
14 rower, upon a finding that the borrower has, or will
15 have, the ability to repay its existing and proposed in-
16 debtedness.”;

17 (3) striking out the penultimate sentence and in-
18 sserting in lieu thereof the following: “As used in this
19 title, a guaranteed loan is one that is initially made or
20 refinanced, held, and serviced by a legally organized
21 lending agency or lender approved by the Administra-
22 tor and that is guaranteed by the Administrator here-
23 under.”; and

24 (4) adding at the end thereof new subsections (b)
25 and (c) as follows:

1 “(b) Not later than ninety days after the effective date of
2 the Rural Electrification and Telephone Revolving Fund
3 Self-Sufficiency Act of 1983, the Administrator shall promul-
4 gate rules and regulations for the guarantee of loans and the
5 accommodation and subordination of liens or mortgages, as
6 provided in subsection (a) of this section. The rules and regu-
7 lations promulgated under this subsection shall not take effect
8 until (1) such rules and regulations have been transmitted to
9 the Senate Committee on Agriculture, Nutrition, and Forest-
10 ry and the House Committee on Agriculture and (2) the expi-
11 ration of thirty calendar days of continuous session of Con-
12 gress after the date of such transmittal.

13 “(c) Whenever the interest rate on any advance under a
14 loan that has a remaining term of seven years or more and
15 that is guaranteed by the Administrator and made by a
16 lender under this section exceeds the rate of interest applica-
17 ble on other similar new advances then being made or pur-
18 chased by one hundred basis points (1 per centum) or more,
19 the lender is authorized, upon the request of the borrower, to
20 adjust the interest rate on such advance, without penalty, to
21 the interest rate than applicable to other similar new ad-
22 vances then being made or purchased by the lender: *Pro-*
23 *vided*, That no interest rate on such advance shall be read-
24 justed at intervals of less than seven years.”.

1 **SEC. 8.** Section 307 of the Rural Electrification Act of
2 1936 (7 U.S.C. 937) is amended by inserting before the
3 period at the end thereof a colon and a proviso as follows:
4 “*Provided*, That in any fiscal year for which the minimum
5 loan level, as established by law, is less than \$1,000,000,000
6 for insured loans for rural electrification, rural electrification
7 borrowers shall obtain concurrent supplemental financing in
8 accordance with the applicable criteria and ratios in effect for
9 fiscal year 1983 under Public Law 97-370, 96 Stat. 1801,
10 enacted December 18, 1982”.

11 **SEC. 9.** Section 406(a) of the Rural Electrification Act
12 of 1936 (7 U.S.C. 946(a)) is amended by striking out “but
13 not later than fiscal year 1991” in the second sentence.

14 **SEC. 10.** Section 408 of the Rural Electrification Act of
15 1936 (7 U.S.C. 948) is amended by—

16 (1) striking out everything in the first sentence of
17 subsection (a) after “class C stock” down through the
18 end of the sentence and inserting in lieu thereof a
19 period;

20 (2) in paragraph (4) of subsection (b), adding “and
21 income taxes” after “before interest”, and striking out
22 “higher” and inserting in lieu thereof “other”; and

23 (3) striking out paragraph (5) of subsection (b) in
24 its entirety and redesignating paragraphs (6) and (7) of
25 subsection (b) as paragraphs (5) and (6), respectively.

1 SEC. 11. Section 410 of the Rural Electrification Act of
2 1936 (7 U.S.C. 950) is amended by striking out subsection
3 (b) in its entirety and by redesignating subsection (c) as sub-
4 section (b).

5 SEC. 12. This Act shall become effective on the date of
6 enactment: *Provided*, That during the period between the ef-
7 fective date of this Act and the effective date of the rules and
8 regulations required to be promulgated under section 305(b)
9 of the Rural Electrification Act of 1936, as amended herein,
10 the Administrator of the Rural Electrification Administration
11 shall continue to make insured loans under the Rural Electri-
12 fication Act of 1936 at the interest rates specified in section
13 305(b) prior to its amendment by this Act.

○



DEPARTMENT OF THE TREASURY
OFFICE OF THE GENERAL COUNSEL
WASHINGTON, D.C. 20220

October 4, 1983

Dear Mr. Chairman:

The Department would like to take this opportunity to comment on H.R. 3050, the "Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983", which has been referred to your Committee. The Department strongly opposes enactment of H.R. 3050. It would add to the billions of Federal dollars already granted under existing subsidy programs to rural electric cooperatives. The further large increases proposed under H.R. 3050 are not justified. The Department's comments on specific provisions of the bill are detailed below.

Under existing law, the REA direct loan program is financed by (1) \$7.9 billion of borrowings from Treasury which were outstanding when the Rural Electric and Telephone Revolving Fund was established in 1973 (the 1973 legislation repealed the requirement for the payment of interest to Treasury on this borrowing), (2) the sale to the Federal Financing Bank of certificates of beneficial ownership (CBOs) in the portfolio of direct loans, (3) authorized appropriations, and (4) authority to borrow from Treasury at current Treasury borrowing costs.

Section 4 of the bill would repeal the requirement for repayment of the \$7.9 billion of borrowings from Treasury. The Department is not aware of any justification for the proposed cancellation of REA debt. While debt cancellation could be justified to the extent of realized loan losses, this justification is absent in the case of the REA program. Moreover, since this additional \$7.9 billion of financing for the program would be provided outside of the budget/appropriations process, it would constitute backdoor financing. Accordingly, the Department is opposed to section 4.

Section 5 would authorize the Administrator to repurchase without penalty CBOs sold to the FFB whenever the interest rate on an outstanding CBO is at least 100 basis points higher than the current FFB rate. Thus, in a period of declining market interest rates, the Administrator could continuously refund the entire portfolio of some \$3.3 billion of CBOs at successively lower interest rates and then simply wait out any periods of rising market rates. This proposal would provide substantial benefits to the fund at the expense of the FFB and the Treasury. Accordingly, the Department is opposed to section 5.

Section 7 would provide a similar rollover privilege for guaranteed borrowers from the Federal Financing Bank except that such rollovers could only occur every 7 years. That is, if the current FFB lending rate were at least 1 percentage point below the rate on an outstanding guaranteed loan, the borrower could request that the loan be refinanced without penalty at the current FFB rate. This proposal suffers from the same criticism as the proposal to refinance CBOs discussed above. FFB and REA have agreed in principle to permit REA-guaranteed borrowers to fund projects with rollovers of short-term debt during the up to 35-year period when an advance is outstanding. The contractual terms, which are now being worked out between FFB and REA, would be more flexible than the legislative language proposed in section 7 of the bill and would recognize the rights and obligations of all of the parties to the guaranteed loan contract.

Under existing law, REA makes direct loans at 5 percent (the standard rate) and at 2 percent (the special rate). Section 6 would amend existing law to authorize the Administrator, from time to time, to establish the interest rate for new loans made during a given period so that the interest income from new loans just covers the Administrator's anticipated interest expense on new borrowings during that period. Standard loans would bear interest at the rate so determined, but not less than 5 percent. Special loans would bear interest at not less than 2 percent nor more than one-half the standard loan rate. We understand that the effect of section 6 would be to increase the standard loan rate to about 6 percent.

Experience with Federal credit programs demonstrates that fixed interest rates, such as the 5 percent and 2 percent rates prescribed in the REA statute, produce perverse and unintended variations in interest rate subsidies as market rates of interest vary. This results in inequities among borrowers using the program at different times and in extraordinary demands for Federal loans at times of highest market rates of interest, which are also likely to be the times of greatest inflationary pressures and need for budgetary restraint. For example, at the current cost of long-term Treasury borrowing of about 12 percent, the cost of making a typical 35-year loan at 5 percent in the amount of \$3 million is the same as the cost of providing an outright grant of \$1.5 million and requiring the remaining \$1.5 million to be paid with interest at 12 percent. Yet in 1973, when the 5 percent rate was established for the REA program, the Treasury's long-term borrowing rate was only about 7 percent, so the cost to the Government, and the subsidy to new borrowers, has risen substantially over the past decade because of the increase in market rates of interest rather than an increase in the need for the subsidy. The Department, therefore, opposes interest subsidies of this nature.

The Treasury has long maintained that the benchmark interest rate for Federal lending programs should be the current cost of Treasury borrowing for a period comparable to the maturity of the loan. The essence of the argument is that while the Treasury does not enter the market to borrow a specific amount for a specific maturity to finance a loan in that amount at that maturity, it is compelled to have a comparably greater amount of debt outstanding over the life of the loan. Thus, the best measure of the cost of the loan is the current market borrowing cost for comparable maturities. Any interest rate subsidies deemed necessary should be provided at a fixed spread below the Treasury borrowing rate. Under this approach, the interest rate subsidy is explicit. Accordingly, the Department is opposed to section 6 of the bill.

Under existing law, the REA Administrator is authorized, but not required, to guarantee loans to rural electric and telephone borrowers and to subordinate direct loans to other financing obtained by such borrowers. Section 7 of the bill would amend existing law to require the Administrator to guarantee such loans and to subordinate REA direct loans at the request of the borrower. Such subordination would substantially increase the Government's risk. Also, since eligible borrowers include States and municipalities, the guarantee and/or subordination of the aforementioned loans would result in the Federal guarantee of tax-exempt obligations.

The Administration is strongly opposed to Federal guarantees of tax-exempt obligations. Placing the credit of the United States behind a tax-exempt obligation creates a security that is superior to direct obligations issued by the U.S. Treasury and is contrary to the spirit of the Public Debt Act of 1941, which prohibits direct issuance by Federal agencies of obligations the interest on which is exempt from Federal income taxation. Federal guarantees of tax-exempts also have adverse effects on the municipal market, because they create securities which are superior to all other tax-exempt securities issued by State and local entities. Consequently, such guarantees add to the pressures on the municipal bond market, crowd out other, less creditworthy municipal borrowers, and increase the borrowing costs of all municipal borrowers. A guarantee of a tax-exempt obligation is an inefficient means of Federal financing because the revenue loss to the Treasury greatly exceeds the interest benefits to the borrower of the tax exemption. Since 1970, Congress has enacted at least 24 statutes which preclude Federal guarantees of tax-exempts and in many cases authorize more efficient means of providing Federal credit assistance to the affected borrowers. As indicated in the enclosed list, these statutes affect virtually every sector of the economy -- agriculture, community facilities, education, energy, housing, rural business and economic development, and transportation. Accordingly, the Department is opposed to section 7 of the bill.

The rural electric cooperatives have benefitted from a wide range of subsidies, including subsidized direct loans and 100 percent loan guarantees, tax-exempt status, retention of essentially tax-exempt status while taking advantage of tax incentives (e.g., Safe Harbor leasing) available to fully taxable entities, tax-exempt municipal bonds for pollution control equipment, and preferential access to low cost Federal power. No justification for the large increases in subsidies and U.S. Government risk proposed by the bill has, however, been provided. Thus, no further subsidies are warranted. We, therefore, strongly urge the Committee to reject this legislation.

The Office of Management and Budget has advised that there is no objection to the submission of this report to your Committee, and that enactment of H.R. 3050 in its present form would not be in accord with the President's program.

Sincerely,

Gada Lake

~~Margery Waxman~~

Deputy General Counsel

The Honorable
E de la Garza, Chairman
Committee on Agriculture
House of Representatives
Washington, D.C. 20515

Enclosure

Statutes which preclude Federal guarantees of
tax-exempt obligations

1. Loans for modernization and construction of hospitals and other medical facilities; P.L. 91-296, June 30, 1970, 42 U.S.C. 291j-7(e). 1/2/3/
2. New Community debentures; P.L. 91-609, December 31, 1970, 42 U.S.C. 4514. 2/3/
3. Water and waste facility loans sold out of the Agricultural Credit Insurance Fund; P.L. 91-617, December 31, 1970, 7 U.S.C. 1926(a)(1). 2/3/
4. Farm Credit Administration member institution guarantees; P.L. 92-181, December 10, 1971, 12 U.S.C. 2204.
5. Academic facilities loan insurance, P.L. 92-318, June 23, 1972, 20 U.S.C. 1132c-5.
6. Washington Metropolitan Area Transit Authority obligations; P.L. 92-349, July 13, 1972, D.C. Code 1-1441 note, 2/3/
7. Loans sold out of the Rural Development Insurance Fund; P.L. 92-419, August 30, 1972, 7 U.S.C. 1929a(h). 2/
8. Vocational rehabilitation facilities mortgages; P.L. 93-112, September 26, 1973, 29 U.S.C. 773(c).
9. National Railroad Passenger Corporation guaranteed obligations; P.L. 93-146, November 3, 1973, 45 U.S.C. 602(g).
10. Loan guarantees for initial operating costs of health maintenance organizations; P.L. 93-222, December 29, 1973, 42 U.S.C. 300e-(c)(3). 2/
11. Loan guarantees to assist the economic development of Indians and Indian organizations; P.L. 93-262, April 12, 1974, 25 U.S.C. 1451.
12. State housing finance and State development agency obligations; section 802 of P.L. 93-383, August 22, 1974, 42 U.S.C. 1440. 2/3/

13. Guarantees of obligations issued by coastal State and local governments to finance projects associated with the development of Outer Continental Shelf energy resources; section 7 of P.L. 94-370, July 26, 1976, 16 U.S.C. 1456a. 2/3/
14. Guarantees of Virgin Islands Bonds; P.L. 94-392, August 19, 1976, 48 U.S.C. 1574b. 2/
15. Loan guarantee program for acquisition of property (urban renewal); section 108 of P.L. 93-383 as amended by P.L. 95-128, October 12, 1977, 42 U.S.C. 5308. 2/3/
16. Guarantees of obligations issued by State and local governments to finance essential community development and planning occasioned by Federally assisted alternative fuel demonstration facilities; section 19(k) of the Federal Nonnuclear Energy Research and Development Act of 1974, as added by section 207(b) of P.L. 95-238, Feb. 25, 1978, 42 U.S.C. 5919. 2/3/
17. Guarantees for startup and construction costs of municipal or industrial waste treatment and synthetic fuels demonstration facilities; section 19(y) of the Federal Nonnuclear Energy Research and Development Act of 1974, as added by P.L. 95-238, Feb. 25, 1978, 42 U.S.C. 5919. 2/3/
18. New York City loan guarantees; section 103 of the Internal Revenue Code of 1954, as amended by section 201 of P.L. 95-339, August 8, 1978, 26 U.S.C. 103. 2/
19. Loan guarantees of the National Consumer Cooperative Bank; section 108(c) of P.L. 95-351, August 20, 1978, 12 U.S.C. 3018.
20. Guarantees of combination financing for hospitals and guarantees of combination refinancing for multifamily housing projects; section 242 of the National Housing Act, as amended by section 315 of P.L. 96-153, December 21, 1979, 12 U.S.C. 1715z-7.
21. Loan guarantees to assist the Chrysler Corporation; section 11 of P.L. 96-185, January 7, 1980, 15 U.S.C. 1870.

22. Revenue bonds guaranteed or otherwise secured by the United States Synthetic Fuels Corporation; section 155 of P.L. 96-294, June 30, 1980, 42 U.S.C. 8755. 2/3/
23. Loan guarantees for municipal waste energy projects; section 233 of P.L. 96-294, June 30, 1980, 42 U.S.C. 8833. 2/3/
24. Guarantees of obligations issued to finance ocean thermal energy facilities; section 1110 of the Merchant Marine Act, 1936, as added by section 203 of P.L. 96-320, August 3, 1980, 46 U.S.C. 1279c. 2/

- 1/ Superseded by P.L. 93-641, January 4, 1975, 42 U.S.C. 300q.
- 2/ Statutes which authorize guarantees of taxable municipal obligations.
- 3/ Statutes which authorize interest subsidies on guaranteed taxable municipals.

Mr. JONES of Tennessee. Our witnesses for this morning's session will be several Members of Congress, the Governor of North Dakota, and representatives from the Department of Agriculture. Again, for the sake of time I would hope that we can forego questioning the Members of Congress at this time, since they are always available to us, and instead communicate with them in writing if we have any followup questions about their testimony.

Now I would like to ask if there is any member of the subcommittee who desires recognition at this time for the purpose of making any sort of a statement.

Mr. English.

OPENING STATEMENT OF HON. GLENN ENGLISH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. ENGLISH. Thank you very much, Mr. Chairman.

I think you have pointed out very clearly the significance of these hearings, and perhaps it would be helpful to underscore once again what I consider to be the real significance of what we are undertaking. What we are looking at is the real question as to whether or not the philosophy in which the Rural Electrification Act of 1936 was passed is going to continue, or whether that is going to change.

We have seen the Government in recent years take some major steps that have increased the burdens on rural people. One of course, is the requirement of Federal law that many of our old gas-fired generating plants convert to coal.

I know in my own State of Oklahoma I recently heard stories—I suppose you could say horror tales—with regard to elderly people who were living either on farms or in small communities served by rural electric cooperatives who used no air conditioning whatsoever and simply had a simple fan, and were experiencing electric rates at \$300 and \$400 per month.

The subcommittee which I chair in Government Operations recently completed hearings on the access charges that will be implemented by the Federal Communications Commission the first of the year, in which we heard that rural rates for telephone service will increase by 200 percent and more.

I think all of this indicates that the Government itself is increasing the cost of service to rural communities, both for telephone service and for electric service. The question now is whether we will take additional steps to further increase that burden, which brings about the real question of whether we will continue to have universal telephone service and whether we will have many of our rural communities, particularly the elderly people living in rural areas, unable to afford electric service.

Therefore, Mr. Chairman, I think these hearings are extremely valuable and very important, and I certainly commend you for holding them.

Mr. JONES of Tennessee. Thank you very much, Mr. English. We do appreciate your statement.

I do want to insist that the members of the subcommittee attend the hearings as much as is possible. I know there are times when everyone cannot be here.

Now I yield to the ranking minority member of the subcommittee, Tom Coleman.

**OPENING STATEMENT OF HON. E. THOMAS COLEMAN, A
REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI**

Mr. COLEMAN. Mr. Chairman, I will be brief because we do have a lot of business before the committee this morning. We certainly are looking forward to the testimony.

I think that it is true that while we are talking about rural America today, and its telephone and its electric service, we are in fact talking about the future direction of rural America in general and the question as to whether or not the programs which were passed many years ago are to be abandoned in the 1980's, or are we going to be able to take a look at them and see if we cannot continue them under better features and formats.

The question goes to the heart, I think, of the existence of our farmers that we try to represent on this committee, the people who live in small towns throughout this Nation. I certainly hope that something constructive will come out of these hearings and the bill that we have introduced. I look forward to working with everyone involved in order to insure that rural America will continue to be served as well as it has been in the past. Let's face it: Thanks to the co-ops and the telephone companies, rural life has been made a lot better and a lot easier and certainly more efficient over the years.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman, for those fine remarks.

Now to Mr. Stenholm.

**OPENING STATE OF HON. CHARLES W. STENHOLM, A
REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS**

Mr. STENHOLM. Thank you, Mr. Chairman.

I have a prepared statement that I would like to put into the record and just briefly make a couple of points.

As a manager of a rural electric cooperative for 9½ years, I believe that H.R. 3050 is the fiscally responsible way for this country to insure a sound Revolving Fund but, more importantly, a sound rural electric program. The basic question that this subcommittee and this committee and the Congress are going to have to answer is whether we want to continue a policy of area coverage at affordable rates.

That is the basic question that we have to answer. If the answer is no, then there is no point in H.R. 3050, but if the answer is yes, then I think that as we get more into the details of H.R. 3050 and the tremendous amount of work that has gone into this piece of legislation by the rural electric cooperatives of this country, that more and more we will begin to see that this is the fiscally responsible way to address the problem of the future of rural electrification.

I think that, given the problem of deficits that we have today and the problem of expenditures and the tremendous pressures on the budget, more and more we will see that by providing for a re-

volving fund with a cap, so to speak, on the total amount of commitment, and putting the responsibility on the rural electric cooperatives not only to devise a program today, but also to devise one that will be just as good 10, 15, or 20 years from now, is going to be the way to go.

I thank the chairman for his efforts to bring this to these hearings today.

[The prepared statement of Mr. Stenholm follows:]

STATEMENT OF
HONORABLE CHARLES W. STENHOLM

Mr. Chairman, I commend you for holding hearings on H.R. 3050, the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983. I am pleased to be one of many co-sponsors of this legislation, and I hope it will move speedily through our subcommittee and the full committee.

I managed a rural electric cooperative for nine and a half years, so I have been aware of the problems our rural electric system has for some time. I believe H.R. 3050 is a fiscally responsible and far-sighted plan to ensure the future stability of the REA Revolving Fund and provide continued reliable and affordable electric and telephone service to rural America.

As Congress considers the problems of rural electrification, we need to keep in mind a basic philosophic question: Do we, as a nation, want to ensure affordable area coverage for our rural areas? If we do not, then everything else is moot. But if we do -- and that has been the will of Congress for nearly half a century, and the current Administration has not disputed it at least in concept -- then something very much like H.R. 3050 will be necessary. There may be improvements that can be made in this bill, but to reject it out of hand as some have done is not responsible.

I have been in Congress only a little over four years, but I cannot remember very many interest groups which have come to me and said: Please raise the interest rate we pay the federal government. Yet that is precisely what the rural electric cooperatives are asking. They have very wisely decided that it does not make much sense to depend on annual appropriations -- either fiscal sense or, frankly, political sense. It makes a great deal more sense to strengthen the

Charles W. Stenholm

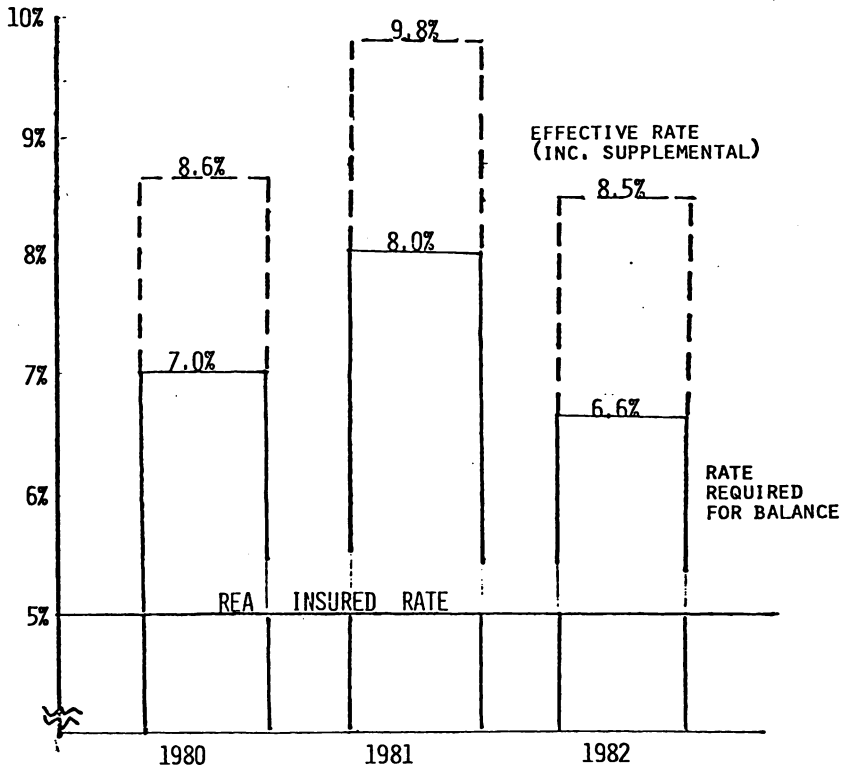
integrity of the Revolving Fund itself, as H.R. 3050 does.

I want to clear up one point about the interest rates rural electric cooperatives pay. A statutory rate of 5 percent does not mean an effective rate of 5 percent, because a portion -- usually 30 percent -- of a co-op's borrowings are made at a higher market rate. Thus, for example, if H.R. 3050 had been the law during the period 1980 through 1982, the effective rate paid by co-ops would have varied between 8.5 and 9.0 percent. H.R. 3050, of course, would raise even the REA insured rate above its present 5 percent -- but my point is that the effective rate is higher than that, under either current law or the proposed changes.

Some propose that REA's interest rates should be based on the cost of borrowing to the Treasury. Under the new formulas, the effective rate that the co-ops end up paying will approach this level, but it is not really necessary to peg it there to ensure the soundness of the Revolving Fund.

In summary, Mr. Chairman, I have to ask my colleagues: How many interest groups have come to you and asked you to raise their interest costs? I can't think of many. I believe the electric cooperatives have taken the course of fiscal responsibility, and I applaud the work of our chairman and others who want to chart a sound course for the future.

REA RATE REQUIRED FOR BALANCE



Mr. JONES of Tennessee. Thank you very much, Mr. Stenholm. Without objection, your entire statement will be made a part of the record, and we do appreciate the fact that you are filing it.

Now Mr. Skeen is recognized.

**OPENING STATEMENT OF HON. JOE SKEEN, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF NEW MEXICO**

Mr. SKEEN. Thank you, Mr. Chairman. I am not going to take much time because I do want to get into the hearings, just as you do.

It is important to understand, however, what has happened with some of the programs that were initiated in the thirties. As one who still lives in a very rural community, became a member of an REA co-op in 1955 and prior to that time had been generating my own electricity, I am probably the last Member of Congress to be furnished telephone service—which was 1 year ago on my birthday, June 30, 1 year ago.

However, it is apparent to me that programs don't stay as you initiate them. Things change. The financial and economic situation in the United States has changed drastically, and I think that along with that change, it requires some innovation, even legislative innovation. I think that is what we are trying to approach, Mr. Chairman.

I do commend you on the approach and understanding that we do have to change our view of the programs that we designed and inaugurated some years ago. They worked very well. We want them to continue working well. We want to continue providing that kind of service for Americans, particularly those agricultural Americans.

Therefore, once again I commend you, and am very much interested in getting on with the hearings.

Mr. JONES of Tennessee. Thank you very much, Mr. Skeen, for your statement and for your cooperation.

Now I am going to pass over Mr. Tallon, because he has a witness he wants to say something about in just a moment, and recognize Mr. Morrison.

**OPENING STATEMENT OF HON. SID MORRISON, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF WASHINGTON**

Mr. MORRISON. Thank you, Mr. Chairman.

This is a very important issue for my rural area, which is over half of the geography of the State of Washington, and I am eager to get on with the hearings.

Mr. JONES of Tennessee. Thank you very much, Sid.

Mr. de la Garza, would you like to be recognized at this time? I know your time is of essence.

**OPENING STATEMENT OF HON. E (KIKI) de la GARZA, A
REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS**

The CHAIRMAN. Thank you, Mr. Chairman.

Like the rest of my colleagues, I will submit a prepared statement for the record. I do support this legislation for one very simple reason: A half-day drive through any section of my congres-

sional district will convince anyone of what REA has done and still needs to do, and why we should continue it.

If you have no objection, I would submit a statement for the record.

[The prepared statement of Mr. de la Garza follows:]

STATEMENT OF THE HON. E DE LA GARZA
BEFORE THE HOUSE COMMITTEE ON AGRICULTURE
SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

HEARINGS ON H.R. 3050
THE RURAL ELECTRIFICATION AND TELEPHONE REVOLVING FUND
SELF-SUFFICIENCY ACT OF 1983

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to join you today in offering my views and support for H.R. 3050, the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983. I believe this legislation clearly reflects the strong bipartisan Congressional support the REA program still enjoys after nearly 50 years of service to America.

I will not take this time to go point-by-point through this legislation as I am sure the issues will be adequately addressed by the many witnesses who will be appearing before you in the next two days. Rather, I would like to focus my comments on what I regard to be the major issue to be resolved through this legislation, that is, what should the level of public investment be in rural America?

One of the most pressing publicly debated issues in rural America today is the question of the availability and cost of investment capital, whether public or private, and how best to supply and allocate this limited capital. I submit that this legislation is an outgrowth of that public debate and it will give the Congress the opportunity to debate and choose how best to allocate public resources for the well-being of all Americans.

Certainly one could argue that the public investment in programs like REA, the interstate highway system and water and sewer assistance has benefitted rural America. These same investments have benefitted all Americans whether through better transportation of agricultural products to urban retail centers, or lower on-farm energy cost which translate to lower food costs. The simple truth of the matter is that public investment that we as a Nation have deemed appropriate, has paid dividends to all. The question we then face is whether we should continue to support the basic REA programs that have served rural areas so well in the past.

Rural electric and telephone cooperatives by and large serve thinly populated territories where investor owned utilities could not or would not serve in the past. They have brought needed utility services to their rural constituencies regardless of cost. Electric cooperatives have built and maintained 50 percent of the nation's electric lines, yet they account for less than 10 percent of the total electric sales. The average electric cooperative's revenue per mile is about 8 percent of that enjoyed by the average power company, and their consumer density is just 13 percent of a typical investor-owned utility. The rural electric cooperative average investment per consumer is 126 percent of investor-owned utilities. To require these rural

entities to acquire a much larger share of their total investment needs through the private money market would not only serve to diminish the economic viability of their system, but it would undoubtedly force most of the small cooperatives into a situation where it would be impossible for them to borrow at any cost due to lack of repayment ability. Are we willing to risk the public investment already made to these entities in order to be able to say we have saved a few Federal dollars? I must question the advisability of such a policy especially where the impact would be so severe to most of our agricultural producers and to those individuals who service the agricultural sector located in rural America.

Rural telephone cooperatives are also faced with great uncertainty in view of the pending breakup of the AT&T network. Now more than ever before our rural telephone cooperatives must be financially strong to meet the challenges of the future. The investment that the cooperatives will have to make in order to remain competitive and provide adequate telecommunication services to their rural constituencies will be enormous. The access to credit for these institutions should be protected and in my opinion that is exactly what we will be doing through this legislation. The viability of the REA Revolving Fund as a source of investment capital is essential to the rural electric and telephone cooperatives. The mere fact that the cooperatives have come to us and asked for changes in the law which will have the effect of adding additional cost to their programs and which they must bear themselves suggests to me a willingness to shoulder a greater financial responsibility in providing adequate energy sources and communication needs in rural areas which directly or indirectly provide benefits to all Americans.

Finally let me say that if this legislation is viewed simply as another government "bailout" the generalization is a gross misrepresentation of the real issue. This legislation seeks to answer the question of what level of public investment should be made in rural America and whether that investment will bring benefits which will accrue to all Americans? I am confident that this legislation is a good investment for all Americans to make and I urge you to support it fully.

Mr. JONES of Tennessee. Thank you very much, Mr. Chairman. We appreciate your presence, and hope that you can be with us part of the time, if not all of the time. Without objection, your statement will become a part of the record and will be given due consideration.

This morning we are going to change the witness list just slightly. Mr. Ridge, I am going to have to apologize to you because Mr. Derrick is a member of the Rules Committee, which is a very important committee around here. They are fixing to meet or are meeting now. I am going to recognize Butler Derrick, who is No. 2 on the list this morning, so he can get on with the business of the Rules Committee, if you don't mind.

Mr. RIDGE. Not at all.

Mr. JONES of Tennessee. Therefore, I am going to yield to Robert Tallon for a word about Butler Derrick.

Robert.

Mr. TALLON. Thank you, Mr. Chairman.

It is just a real honor and pleasure for me to welcome our distinguished colleague from South Carolina, Mr. Butler Derrick, here today. I particularly owe a debt of gratitude to Butler. He is the senior Democrat of our South Carolina House delegation. He shared his insight and knowledge with me, and really helped me learn the political process here in Washington.

Butler, we are very grateful for your assistance. I thank you for being here today, and I thank you for your friendship.

STATEMENT OF HON. BUTLER DERRICK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH CAROLINA

Mr. DERRICK. Thank you, Robin. I am delighted to be here.

I have a statement. I ask unanimous consent that it be included in the record.

I am so very appreciative, Mr. Chairman, of the opportunity to be here today to appear before you and your colleagues on the Subcommittee on Conservation, Credit, and Rural Development, on a piece of legislation which is of vital importance to rural America, H.R. 3050, the Rural Electrification and Telephone Revolving Self-Sufficiency Act of 1983.

I want to digress for just a moment here, if I may. Some of the statements that have just been made about the need to move ahead with rural electrification and rural telephone service, I think, you know, my generation doesn't remember what it was like to live in the country without telephones and without electricity. My grandparents got electricity just about a year or two after I was born, and I don't really remember it.

However, I have read several books recently on rural electrification and what it meant, and rural telephones, what they meant to the people of this country. I mean, it just opened up an entirely new way of life to them. It saved women from becoming old before their time. It gave farmers an opportunity to make a decent income. I think that it is awful easy for us to take many of those things for granted now. I hope that this legislation will pass, and I think it will certainly be a step in the right direction.

I have the privilege of representing the Third Congressional District of South Carolina, a district which is primarily rural in its character. Rural electric and telephone systems are essential services which have provided many of my constituents with electricity and telephones they may not otherwise have.

Approximately 300,000 consumers are currently served by rural electric systems in South Carolina. In 1935, only 2 percent of South Carolina's farms were electrified. By 1978, that percentage has climbed to 98 percent.

The rural telephone systems in South Carolina serve 15,000 businesses and 141,000 residential telephone subscribers. At present, some 19 rural telephone corporations in South Carolina borrow from the revolving fund.

As these numbers indicate, Mr. Chairman, rural electric and telephone services have and will continue to have substantial impacts on rural America. Since 1935 the Congress, most administrations, and rural electric and telephone leadership have worked hand-in-hand to provide the necessary financial mechanisms to allow this service to be delivered efficiently.

Without question, changes have been made throughout the lifetime of rural electric and telephone programs. What started out as a low-interest loan program using Treasury funds for 100 percent its capital needs has evolved into a program where some 85 percent of the necessary capital is obtained at a market rate of interest.

The challenge before us today is to maintain the economic solvency of the financing system which supports these vital services, while recognizing changes in the economic climate which necessitate greater reliability on market interest rates. It is only with a healthy, viable, and self-sufficient REA loan program that we can maintain and expand energy supplies and communication services to support the productive capacity of our farm and rural communities.

Fundamentally, Mr. Chairman, this initiative revolves around a question of need—whether the need for rural electric and telephone services will continue in the foreseeable future. I, for one, believe it will.

Over the next several days as you hear testimony on this bill, I would anticipate that you may hear from some witnesses who might find dispute with some of the provisions of the bill. It will be important, therefore, to keep in mind the focus of our efforts. Our efforts should be aimed at the overriding need for providing essential services—which are taken for granted by the majority of the citizens of this Nation—to areas which would not have such services but for the existence and viability of our rural electric and telephone cooperatives.

With this perspective in mind, I believe we can foster constructive dialog culminating in the passage of H.R. 3050. The changes called for in this bill are sound, and are intended to keep the Revolving Fund self-sustaining. Passage of this legislation will enable rural electric and telephone systems to continue to shoulder the energy, communication, and economic responsibilities of rural areas across the Nation.

Specifically, this bill will allow the REA Administrator to set the rate on new REA loans at a level sufficient to cover REA interest

expenses. Through a mix of old, low-interest loans being repaid to REA and market rate certificates, REA will be able to continue to provide loans to co-ops at interest rates considerably below the prevailing commercial market rate. Most importantly, this proposal will render REA self-sufficient.

Mr. Chairman, you are to be commended for pursuing consideration and approval of this legislation. I am also assured in knowing that the interests of South Carolina are most capably represented on your committee by my distinguished colleague and friend, Robin Tallon.

H.R. 3050 is a balanced approach toward reaching a most worthy and significant goal. I am pleased to note that the bill is cosponsored by 173 of our colleagues, and carries the strong endorsement of the co-op members. I am pleased to be a part of this effort, and pledge my energies toward early passage of this important legislation.

I thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Butler.

Mr. DERRICK. I understood you wanted to have questions done by letter. Is that correct?

Mr. JONES of Tennessee. That is correct. We will not take the time or take your time as Members of Congress to ask you questions. We will communicate by letter if there are questions to be asked.

Mr. DERRICK. I thank you, and I thank my colleague, Mr. Ridge, for allowing me to go first. Having made my statement, I am going to go up to the Rules Committee and see what devilment we can get into up there.

Mr. JONES of Tennessee. Thank you very much, Butler, for being here. We appreciate your support more than you know.

Now we will go back to witness No. 1, the Honorable Thomas Ridge, a Member of Congress from the State of Pennsylvania.

Mr. Ridge, we are delighted that you are here. You may proceed.

**STATEMENT OF HON. THOMAS J. RIDGE, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF PENNSYLVANIA**

Mr. RIDGE. Thank you, Mr. Chairman. I appreciate very much the opportunity to appear before your subcommittee to speak in favor of H.R. 3050, the proposed amendments to the Rural Electrification Act.

Most often when people think of northwestern Pennsylvania, they think of steel and heavy industry. In Pennsylvania's 21st district, which I am proud to represent, we have that. However, in this 2,700 square miles we also have a rural community that basically provides opportunities for the small dairy farmer; we have a wine industry, a grape industry in the community; and so the REA and while the impact of this potential legislation is known nationwide, it is certainly very important to my district as well.

I would appreciate very much the opportunity to submit my entire remarks as part of the record, and paraphrase the statement itself before the subcommittee.

Mr. JONES of Tennessee. Very good. We appreciate that very much. Without objection, your entire statement will become a part of the record.

Mr. RIDGE. Thank you, Mr. Chairman.

As you know, from the very beginning rural electrification has received strong bipartisan support within the Congress. It has received this support because of the challenges it has overcome and the leadership it has provided in the electric utility industry. This bipartisan support is manifest in the cosponsorship of the amendments to the Rural Electrification Act that are before this distinguished committee today.

I am proud to say that my own State of Pennsylvania has contributed more cosponsors to this legislation than any other State. Nineteen of our twenty-three Representatives and both of our Senators are cosponsors of this bill or its counterpart in the Senate.

Until the end of 1972, loans made by the Rural Electrification Administration were funded by money received from the Treasury as a result of annual authorizations. Two new financing programs were established in 1973, an insured loan program and a program of loan guarantees. Neither of the current REA financing programs rely on taxpayers' dollars. They are not part of the Federal budget and do not contribute to the Federal deficit.

The changes that were made a decade ago substantially increased the cost of financing rural electric construction programs. Nonetheless, those changes were made with the full cooperation, participation, and support of rural electric leaders.

I would like to turn to a specific provision in H.R. 3050, perhaps its most controversial provision. This provision would convert notes payable by the REA Administrator to the Treasury into permanent capital of the REA and Telephone Revolving Fund. These notes were executed during the days of the old REA direct loan program to convert congressional authorizations into the actual funds that were lent to rural electric cooperatives.

This provision does not in any way alter the obligation of rural electric cooperatives to repay their loans to the Federal Government. It does, however, provide the Revolving Fund with a stable source of funds for future operations.

This is not a revolutionary proposal. This technique has been used by the Federal Government on at least two other occasions, once with the St. Lawrence Seaway Corporation, and another time with a special revolving fund in the Department of Energy. Private corporations, as you well know, Mr. Chairman, use this technique every day.

This is exactly what is being proposed for the Revolving Fund. Debt instruments—the notes from the REA Administrator to the Treasury—are being converted into assets—capital in the fund that would be owned by the Federal Government. This is not a giveaway because nothing is being given away. The money represented by the notes from the Administrator to the Treasury is currently owned by the Federal Government, and the money that will be represented by the capital in the Revolving Fund will also be owned by the Federal Government.

Finally, in summation, Mr. Chairman, there are five points I believe the subcommittee should remember as it moves forward with

its consideration of this bill: First, the work of rural electrification is not completed. There are always new consumers to be served and old lines to be brought up to modern standards.

Second, the challenges facing rural electric cooperatives today are much as they were almost a half century ago when REA was established. Rural electric cooperatives still serve the most remote, most rugged, and most sparsely settled areas of this country.

Third, the rural electric financing programs represent an attempt by the Government to establish equitable levels of Federal assistance to the various forms of ownership in the electric utility industry.

Fourth, the rural electric cooperatives merit continued Federal assistance because of their remarkable record of fiscal integrity. The repayment record of rural electric cooperatives has been second to none, with defaults totaling less than \$50,000 out of the \$35 billion of loans and loan guarantees that have been made during the last half century.

Finally, Mr. Chairman, all Americans have a stake in keeping the electric rates paid by our Nation's farmers and ranchers at reasonable levels.

I want to thank you, Mr. Chairman, and the members of your subcommittee, for permitting me this opportunity to comment on this piece of legislation. I sincerely hope the subcommittee will move forward to report this important measure in a timely fashion. This legislation means much, not only to my own constituents in northwestern Pennsylvania but, as you well know—and I am probably preaching to the choir—to millions of other Americans who live in rural areas throughout our country.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Ridge appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Ridge, for a very enlightening statement. We do appreciate the time that you have given us and the fact that you allowed Mr. Derrick to go first.

Mr. RIDGE. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Our next witness is the Honorable William F. Clinger, Jr., a Member of Congress from the State of Pennsylvania.

Mr. Clinger, we are delighted that you are here, and you may proceed.

STATEMENT OF HON. WILLIAM F. CLINGER, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. CLINGER. Mr. Chairman, I thank you very, very much for permitting me this opportunity to be here before the subcommittee to speak in favor of H.R. 3050, the proposed amendments to the Rural Electrification Act.

I might say, Mr. Chairman, that I could almost say ditto to Congressman Ridge's comments because I think that I share completely the sentiments that he expressed in his testimony. However, I would like to ask that my statement be submitted for the record, and I will just briefly summarize my remarks.

Mr. JONES of Tennessee. Without objection, it will become a part of the record.

Mr. CLINGER. Mr. Chairman, I come from a very rural part of Pennsylvania, a very large, sparsely settled area. Unlike people who live in the more urban areas, I think we appreciate very fully exactly what the REA has meant in rural areas of this country.

As recently as 1935, only 24 percent of the farms in Pennsylvania had electric service. This was at a time when the national figure was only 10 percent. The first rural electric cooperative was established in my area in 1936, and it really was a revolution. I mean, it really meant the difference between living a modern life with a quality of life that was reasonable, and living a life in darkness and without any kind of the modern amenities. It really turned the area around in terms of its ability to enjoy economic development. We ran lines all over the valleys and up and down the mountainsides of western Pennsylvania and, as a result, we finally entered the 20th century somewhere around 1940.

From 1935 to 1972, rural electric cooperatives received low-interest loans from REA that were directly funded by the Federal Treasury as a result of annual authorizations. As you know, Mr. Chairman, in 1972 Congress replaced the direct loan program with two new financing programs: a program of loan guarantees and a program of insured loans.

The REA guaranteed and insured loan programs that Congress established a decade ago have, I believe, generally worked extremely well. As you are aware, there are storm clouds on the horizon. The unprecedented interest and inflation rates of recent years have threatened to throw the Rural Electric and Telephone Revolving Fund out of balance by the end of this decade.

As you know, Mr. Chairman, a blue-ribbon committee of rural electric leaders was formed to explore potential solutions to the problems faced by the Revolving Fund. The results of the committee's work are largely incorporated in the legislation before the subcommittee today.

I would just like to reiterate the five reasons that Mr. Ridge quoted which I believe warrant wholehearted support of this legislation. First, the work of rural electrification is not completed. Each year new people move into rural areas. Even though we have provided services for most of those who have been there, there are constantly new people moving into the rural areas. Many of the lines in these areas are 30 to 40 years old and need replacement.

Second, the challenges facing rural electric cooperatives today are much as they were almost half a century ago when REA was established. Since rural electric cooperatives serve the most remote, most rugged, and most sparsely settled areas of the Nation, this creates an imbalance in terms of the kind of assistance that can be provided.

Cooperatives serve an average of only 4.7 consumers per mile of line, while the private power companies serve an average of 35.8 consumers per mile of line. Cooperatives receive revenue that averages only \$3,370 per mile of line. On the other hand, cooperatives' investments in their system average \$1,337 per consumer, as compared with only \$825 per consumer for the private power companies.

Third, Mr. Chairman, the rural electric financing program represent an attempt by the Government to establish equitable levels of Federal assistance to the various forms of ownership in the electric utility industry. Although their investment per consumer and operational costs are significantly higher than those of the private power companies, rural electric cooperatives receive substantially less Federal assistance.

Private power companies receive assistance from the Federal Government totaling about \$3.6 billion per year in depreciation allowances and tax credits. This calculates into Federal assistance to private power companies of about \$50.70 per consumer per year, and to municipal electric systems of about \$40.45 per consumer per year, while Federal assistance to rural electric cooperatives amounts to less than \$9 per consumer per year. I believe it is important to recall and remember that almost all of the assistance received by rural electric cooperatives from the beginning has been in the form of loans that will be repaid to the Federal Government, and not grants or tax writeoffs.

Fourth, rural electric cooperatives merit continued Federal assistance because of their remarkable record of fiscal integrity, referred to by Mr. Ridge.

Fifth, I believe all Americans have a stake in keeping the electric rates paid by our Nation's farmers and ranchers at reasonable levels. The productivity of American agriculture is, to a large extent, dependent on electrical power. As a result, the price that we pay, that all consumers pay—because the price of electricity is reflected in the price of all the produce, whether tomatoes, steak, every quart of milk that Americans consume—the price of the electricity to the farmer is reflected in that price.

Rates charged by rural electric cooperatives nationwide already average 14 percent more than those charged by the neighboring private power company. H.R. 3050 will help moderate the electric rate increases faced by rural electric consumers, but in a very real sense this bill will also help to moderate the price of tomatoes and steak and milk for consumers in cities and towns far from the nearest rural electric cooperative.

In conclusion, Mr. Chairman, I would like to again thank you for allowing me to express my very wholehearted support for H.R. 3050. I join my colleagues who have cosponsored this measure in urging the subcommittee to expeditiously and favorably act on this important legislation.

I thank you very much, Mr. Chairman.

[The prepared statement of Mr. Clinger appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Clinger. We do appreciate your statement. It is a very good statement, and we will be calling upon you if we have some questions to ask you by letter.

Mr. CLINGER. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Our next witness is Mr. Harold Volkmer, a Member of Congress from the State of Missouri and a member of the Agricultural Committee. I believe Harold is not in the room. Is he here?

He asked me if it would be all right to submit his statement, so I am going to ask unanimous consent that he be permitted to submit his statement. If there is no objection, I will see to it that his statement is filed for the record.

Without objection.

[The prepared statement of Mr. Volkmer appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. The next witness is another member of the Agriculture Committee, a good friend of ours and a very helpful member from the State of Minnesota, the Honorable Timothy J. Penny.

Tim, we are glad that you are here, and glad that you would take the time out to submit a statement. You may proceed.

STATEMENT OF HON. TIMOTHY J. PENNY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. PENNY. Thank you, Mr. Chairman and members of the subcommittee.

We all know that if America is to have a strong rural economy, rural Americans must have access to a reliable, affordable electric energy supply. It is unfortunately a harsh fact that the era of cheap energy has ended for rural Americans, as well as for their urban neighbors.

Each year a million more consumers move onto rural electric lines. The challenge of meeting this growth is further compounded by some uncontrollable forces. First, the cost of fuel for generating plants is up as much as 700 percent since 1973.

Second, the cost of maintaining a healthful environment—necessary but expensive—has added as much as 40 percent to the cost of a new coal-fired plant.

Third, construction costs are particularly high for rural electric cooperatives, as these systems own and maintain 44 percent of the Nation's power poles and serve over 70 percent of this Nation's land mass.

These factors, plus the co-op's continuing problem of having low consumer density and difficult terrain, have sent rural electric rates higher in the past several years.

Now is not the time to add yet another burden to the backs of rural Americans. The rural economy is distressed and we all know it. Net farm income has fallen to the lowest level since 1933. It has dropped from \$24.4 billion in 1980 to just \$19 billion in 1982, and with the weather we have had this summer it could go even lower.

Without the passage of H.R. 3050, the rural electric co-ops would have to go to the private money markets to obtain a greater share of their capital. This would, in turn, only serve to raise the cost of borrowing and ultimately force even higher electric rates.

H.R. 3050 would restore strength and long-term stability to the REA financing program. It is important to note when evaluating this legislation that each segment of the electric utility industry receives significant assistance from the Federal Government.

The 97th Congress and the present administration have acknowledged the financial plight of the investor-owned utility by providing them with significant new subsidies through the granting of a

broad range of new tax credits and advantages. I am fully aware of the difficulties these utilities have had in recent years in meeting their capital needs but, at the same time, I am seriously concerned by the administration's continuing unwillingness to support an adequate REA financing program to help meet the equally important capital needs of the rural electric cooperatives.

Mr. Chairman and members of this committee, rural America needs H.R. 3050. I urge its passage.

I want to thank you, Mr. Chairman, and the members of this subcommittee for the opportunity to testify, and for your work and attention to this important issue.

Mr. JONES of Tennessee. Thank you very much, Tim, for a good statement, and for the cooperation and support that we receive from you from time to time. We appreciate very much the time that you are here.

Our next witness is the Governor of the great State of North Dakota, Gov. Allen I. Olson of the National Governors' Association, which he is representing this morning.

Governor Olson, again I want to say to you that we are delighted that you are here. I enjoyed my visit with you earlier this morning and breakfast with you. We appreciate the fact that you had the interest to come down and to be a witness before this subcommittee. You may proceed.

STATEMENT OF ALLEN I. OLSON, GOVERNOR, STATE OF NORTH DAKOTA, REPRESENTING THE WESTERN GOVERNORS' POLICY OFFICE [WESTPO]

Governor OLSON. Mr. Chairman, thank you, first of all. I have great admiration for you in your capacity here as chairman, and also your work on behalf of the conservation of the agricultural soil of this country. From the National Governors' Association and my chair of the task force on soil conservation, I want to tell you how much we appreciate that.

To the members of the Conservation, Credit, and Rural Development Subcommittee I want to say that it is a privilege for me to testify, both as the Governor of my State of North Dakota and on behalf of the Governors of 12 Western States making up the Western Governors' Policy Office which I chair. Today we are here in full support of the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983, H.R. 3050.

The enactment of this legislation is essential to the financial integrity and self-sufficiency of the REA Revolving Fund. This legislation will enable the rural electric and telephone cooperative systems to continue providing reliable, central station service to rural America. This legislation is of the utmost importance to the 25 million agricultural and rural area consumer members being served by electric and telephone cooperatives, and it is for that reason that I appear before you today on behalf of my State, as I said, and representing the Governors of 12 other Western States comprising almost one-half of the total U.S. land area. We are also the States with the lowest population density of any in this country.

The provision of the legislation which provides for periodic adjustment of the interest rate applied to new REA-insured loans is

the key to preserving the financial stability of the Revolving Fund. While this change would result in an increase in the financing costs borne by REA borrowers, we believe strongly, however, that this is a price worth paying to assure the long-term future viability of REA financing.

Another very important element of the overall proposal contained in this legislation is for Congress to convert the funds originally appropriated for REA lending prior to 1973 into a permanent capital investment in the Revolving Fund. Without this change, the Rural Electrification Administration will be required to transfer this capital from the Revolving Fund to the Treasury through annual installments beginning in 1993. This requirement could add significantly to the cost of providing electrical service in rural America. The proposed conversion of approximately \$7.9 billion into a permanent capital investment in the Revolving Fund would not impact on the Federal budget.

Recent public attacks on this legislation falsely imply that rural electric systems are heavily subsidized and that the loans REA has made to them will never be repaid. As previous witnesses have said, both assertions are false and need to be knocked down wherever and whenever they appear. It is absolutely clear that nothing in the proposed legislation would result in the forgiveness of any debt. Both the Revolving Fund and the Treasury are the property of the Government and the people of the United States. The proposed legislation would not in any way reduce the principal or interest amounts to be paid on any loan made by REA to rural electric borrowers. Not a single penny of REA lending would be forgiven under the proposed amendments to the Rural Electrification Act pending before this Congress.

It is important to my State, North Dakota, and other Great Plains and Western States that this legislation provide a mechanism for helping electric and telephone systems providing service under especially difficult circumstances. Strong justification exists for giving special consideration to the relatively few systems that operate under extreme hardship due to the nature of the territories they serve, damage from storms or other natural disasters, or the financial condition of their consumers. For this reason I, along with my fellow Governors, support language that would provide for a special interest rate loan program, including authority for the REA Administrator to make loans under conditions of natural disaster and other hardship at lower, special interest rates of no less than 2 percent.

Three primary conditions necessitate this special provision. Rural electric and telephone systems in the State of North Dakota and other Western States frequently suffer severe damage caused by sleet and windstorms. This damage most often occurs in areas having an average consumer density of two or less per mile, and occurs in geographic areas having low per capita income, forcing the rural cooperative into extreme financial hardship. Therefore, we believe that amendments are needed to meet these special needs of borrowers operating in difficult economic circumstances, particularly those serving sparsely settled rural areas.

This Nation's agricultural industries are highly energy intensive. Our farmers and ranchers are acutely aware of the critical

interdependence between the Nation's agricultural productivity and the need for adequate supplies and dependable sources of energy. The creation of the Rural Electric Cooperative program nearly half a century ago was to epitomize one of the most successful partnerships to form between this Government and its citizens. Since its creation, the rural electrification program has provided rural America with dependable and reasonably priced electric power. The availability of this energy to rural America is today as indispensable to the economic health and vitality of this Nation, and to the continued capacity of the American farmer to produce the food and fiber required by this country and the world, as it has been in the past.

Agriculture is America's national treasure. The benefits that electrification has brought to rural America in creating jobs, in alleviating the drudgery that consumed many farmers' waking hours, in enhancing rural life, and in contributing to the most productive agricultural economy in the world, more than outweigh the relatively small costs of this program. If rural electric cooperatives are to continue their contributions to rural America and are to meet our energy needs for the future, and if rural telephone co-ops are to continue to meet the communication and high-technology needs of our farmers, it is vital that they also have access to the capital that is required to conduct their operations.

Our great American agricultural production machine continues to contribute to the reduction of this Nation's dependence on foreign oil and to the achievement of energy independence for the future. Our rural electric and telephone co-ops play a vital role in maintaining the dependability and reliability of American agriculture.

Mr. Chairman and members of this committee, I thank you for the opportunity to testify on behalf of my State and the Governors of 12 other Western States in support of the amendments to the Rural Electrification Act as a responsible and reasonable response to the needs of rural America.

WESTPO GOVERNORS

Alaska, Bill Sheffield; Arizona, Bruce Babitt; Colorado, Richard D. Lamm; Idaho, John V. Evans; Montana, Ted Schwinden; Nebraska, Robert Kerrey; Nevada, Richard H. Bryan; New Mexico, Toney Anaya; North Dakota, Allen I. Olson; South Dakota, William J. Janklow; Utah, Scott M. Matheson; Washington, John Spellman; Wyoming, Ed Herschler.

Mr. JONES of Tennessee. Thank you very much, Governor.

Let me ask you, Governor, how much time do you have?

Governor OLSON. As much as you need, Mr. Chairman.

Mr. JONES of Tennessee. All right. If you don't mind, we will hear the other witnesses and then we will question all of you at the same time, if it is all right with you.

Governor OLSON. Thank you.

Mr. JONES of Tennessee. Thank you very much.

We are running a little bit ahead of time this morning, doing a little better than usual, and for that reason we will hear the next witnesses before we ask any questions. Our next witnesses are the Honorable Frank Naylor, the Under Secretary for Small Communi-

ties and Rural Development of USDA, and Mr. Harold Hunter, Administrator of the Rural Electrification Administration.

Gentlemen, we are delighted that you are here. Whoever you may have with you from the Department that you would like to bring to the witness table, why, you may do so.

This is an unusual situation for this subcommittee to be running ahead of time as far as witnesses are concerned. We are delighted that we have moved along as rapidly as we have. It goes to show you that when witnesses are well prepared, such as you have been today, it does help an awful lot and we do appreciate it.

We will now hear Mr. Naylor and Mr. Hunter.

Mr. NAYLOR. Mr. Chairman, you are moving along quite rapidly. We were visiting with one of your subcommittee members out in the hallway here, and you almost got ahead of us for a second.

Mr. JONES of Tennessee. Well, we understood you were around, though. We knew you weren't very far away. [Laughter.]

We are delighted that you are here, Frank and Mr. Hunter and Mr. Van Mark. Frank, you may take whatever time is necessary. When you finish, we will bring Governor Olson back and we will ask the questions all at the same time because you will be the only four that we will be questioning at this point.

STATEMENT OF FRANK NAYLOR, UNDER SECRETARY, SMALL COMMUNITIES AND RURAL DEVELOPMENT, U.S. DEPARTMENT OF AGRICULTURE

Mr. NAYLOR. Thank you, Mr. Chairman.

I do not have an opening statement. I believe Mr. Hunter has prepared a statement which will express our views very effectively.

I would only observe that we continue to believe that the Rural Electric Administration has been a valuable asset to rural America, a key asset in providing the infrastructure for power and communications. It has become a very strong and vital industry, and one which enjoys reasonably strong if not, in many parts of the country, very strong financial health.

I feel that it is in that perspective that we share with the committee today the concern that, while well-intentioned, the proposal before us has some very serious flaws and in fact does not really meet the stated objective in returning to financial stability the fund which we are concerned with today.

I would look forward to working closely with this committee—because we are committed to the continuing strength of our rural electric community and rural communications community—to find ways to solve the problems that are before us, as we have always done so well with your committee, Mr. Chairman. We look forward to working together with you on this particular very serious situation.

Mr. Chairman, with that I would turn to Mr. Hunter, who as Administrator of the agency would address specific portions of our concerns with the legislation.

Mr. JONES of Tennessee. Thank you, Frank. As I say again, we are glad that you could be here and accompany Mr. Hunter.

Mr. Hunter, you may proceed.

STATEMENT OF HAROLD HUNTER, ADMINISTRATOR, RURAL ELECTRIFICATION ADMINISTRATION, ACCOMPANIED BY JACK VAN MARK, DEPUTY ADMINISTRATOR AND LARRY BELLUZZO, PROGRAM ANALYSIS STAFF

Mr. HUNTER. Mr. Chairman, members of the subcommittee, we are appreciative of the opportunity to sit here with you this morning and to discuss the details of H.R. 3050. I have some mixed emotions about testifying today; however, I have no negative response to the need for us to look at H.R. 3050. This is a tremendous opportunity that you have provided for us to analyze and to come to a fuller understanding of what H.R. 3050 does.

I do feel gratified that Congress and the trade associations have heeded the alarms that we have sounded over the past several years concerning the deteriorating financial condition of the Rural Electrification and Telephone Revolving Fund. When we first started raising those concerns and suggested types of actions which would help restore the Fund's health, the reaction we received was, and I quote, "If it ain't broke, don't fix it."

I bring to you and would like to leave as a part of our testimony a copy of an ad which appeared in the June 23, 1981, Washington Post. It said, "If it ain't broke, don't fix it." I will only take time to read one short part of the language that was in the ad. That said, and I quote, and I read, "Tampering with this highly successful program is not only unnecessary, it just plain doesn't make sense."

I am very pleased that we have gone from that point to this point now. We need to deal with the Revolving Fund in such a way as to improve its capability to last through the ages and to do some real good for the industry that we serve. The budget proposals of this administration have addressed the concerns by recommending gradually increasing supplemental private financing administratively in order to maintain the Fund's solvency and to achieve the objectives of the 1973 Rural Electrification Act.

Now, rather than solving a potential problem with an administrative solution, the same people who once dismissed our concerns are now seeking major and very costly legislative change, including the immediate forgiveness of 7.9 billion dollars' worth of debts that do not even begin to come due for another 10 years. For good measure, the proposal asks you to deprive Treasury of uncounted billions of additional dollars in future years through mandating one-way, downward-only refinancing of certificates of beneficial ownership—CBO's—and loan guarantees, requiring that the Secretary of Agriculture request direct appropriations to support discretionary reduced interest rate loans. Without these massive additional giveaways, we are told, the long-term viability of the Fund and the REA program is threatened.

Back in 1973 when the Revolving Fund was established, we had a clear expression of congressional intent and a clear consensus as to the purpose and the direction of the Revolving Fund. It was not intended that the Fund require substantial subsidies on a regular basis. The new interest rate in 1973 of 5 percent was close to the then-prevailing cost of money to Government. Further, Congress explicitly stated that the borrowers were to be helped toward gradual financial and operational independence from REA.

Unfortunately, the proposal before us now represents a gross overreaction to the Fund's current problems. We would not suggest that there are not problems. They are real. We were on record that we recognized the problems many months ago. But this proposal represents an attempt to stampede Congress into actions which purport to strengthen the Fund but which, in fact, only serve to delay, at great cost to the taxpayer, the Fund's insolvency. It represents an attempt to perpetuate unrealistically low interest rates, thereby increasing borrower reliance on the Federal Government. Thus, this proposal represents a virtually total abandonment of the congressional consensus we had about the direction and the future of the Fund back in 1973.

As we look back to 1973 when the last major legislative change was made, and the creation of the Fund took place, we can see some of the reason for the Fund's current jeopardy. That jeopardy developed because no one at that time anticipated the critical escalation in interest rates. Therefore, this unanticipated escalation of rates created a disparity between the 5 percent which was set at that time and the cost of Treasury borrowing, and that difference that escalated as the months and years went by.

In 1973, the Revolving Fund was established using \$7.9 billion in interest-free loans from the Treasury as seed money. There was never any doubt that these were loans and that they were to be repaid. We are being told that Congress should forgive them now, because their very existence seems to cause anxiety. We are being told that forgiveness of the loans will have no impact on the public debt.

Well, if this promissory note signed by one of my predecessors is not a loan, I do not know what it is. This is a loan that starts out—and I will read the first part of it very briefly—"On or before December 31, 2010, for value received, the undersigned as Administrator of the Rural Electrification Administration, and not personally, promises to pay to the order of the Secretary of the Treasury \$465,800,000 * * *," and we could go on. It is signed by one of the preceding Administrators of this great agency.

If the existence of this loan and others like it cause anxiety, I can prescribe a simple cure, and that is to raise the Revolving Fund interest rates enough so that the loans can be repaid. The necessary rates do not have to be exorbitant, either. In fact, they could still be up to a couple of percentage points below the Government's own cost of borrowing and balance the Fund. The \$7.9 billion is real money, money that cannot be made to disappear by erasing a number in one column and writing it down in another; money that the Fund owes to Treasury, and money that will have to be raised by taxes or Treasury borrowing if the long-term notes are forgiven.

Again, I make reference to a list that I have in hand of those particular notes that represent this \$7.9 billion. The first note is one that was dated August 14, 1953, and it gives the amount; it gives the due date. There is a list of some 38 notes, all of them owed to the Treasury and all of them due to be paid by the Revolving Fund of REA. If I may, Mr. Chairman, we would like to leave these documents for the record so that they could be read at the convenience of the committee.

Mr. JONES of Tennessee. Without objection, we will be glad to accept those documents for review, Mr. Administrator.

Mr. HUNTER. Thank you, sir.

In 1973 the standard Revolving Fund rate was raised to 5 percent. This increase was intended to assure that the \$7.9 billion in seed money would grow and would—after the repayment of the \$7.9 billion in loans—continue to provide a source of funding for deserving borrowers at reasonable rates. At the same time, the increase to 5 percent brought the Revolving Fund rate more closely into line with the prevailing cost of money to Government.

Now, 10 years later, much of the financial leverage which that \$7.9 billion interest-free loan provided has been used up, but the leverage has not been exhausted. If, for example, Revolving Fund rates were raised to within a couple of percentage points below the Government cost of borrowing, enough revenues would be generated to permit full repayment of the long-term notes, continuing levels of program activity, and absorption of REA's costs for discretionary or reduced interest rate loan activity. Such an adjustment in rates would assure that the Revolving Fund would be a source of adequate funding support at clearly favorable but not excessively low interest rates.

But what does the proposal before us advocate instead? Section 6 of the proposal establishes a formula which would be used to set the Revolving Fund interest rates at levels which will yield sufficient receipts to pay CBO interest expenses, but will not provide for repayment of long-term notes or even the CBO principal. As CBO's or borrowings mature or are paid through amortization, they will be rolled over through the sale of new CBO's or through new borrowing. Consequently, the primary financing vehicle of the Revolving Fund will be annual CBO sales of ever-increasing size—in effect, not a true Revolving Fund.

Of course, for those who are not bothered by increased intrusion of the Federal Government into the credit markets, this proposed new Revolving Fund structure is not a problem. However, the section 6 formula dynamics have one additional result: The formula will almost assuredly result in Revolving Fund insolvency. Even with forgiveness of the \$7.9 billion, the fund will still go insolvent under program growth and cost of borrowing conditions resembling those of recent years.

These conclusions are based on extensive computer modelings of the Fund under the bill's proposal and formula. Mr. Chairman, with your permission I would like to introduce a key staff member of ours who has actually done most of the studies that illustrates what this Revolving Fund conversion does. I would like to have him take just a brief moment to show some charts which give us a very vivid picture of those conclusions.

Mr. JONES of Tennessee. Is that Mr. Van Mark?

Mr. HUNTER. No; that is Mr. Larry Belluzzo. Mr. Belluzzo is the Chief of our Program Analysis Division. He has actually done the computer runs and a financial analysis of the results of this action.

Mr. JONES of Tennessee. Mr. Belluzzo, is he here?

Mr. HUNTER. Yes, he is here.

Mr. JONES of Tennessee. All right, sir. Invite him to the witness table. We will be glad to have him.

Mr. BELLUZZO. Mr. Chairman, members of the subcommittee, as soon as we received the proposed legislation in May, we began modifying our automated Revolving Fund model so that we could analyze on a comprehensive basis the section 6 language and the mechanism contained in section 6 for setting interest rates for the Revolving Fund. Obviously, our purpose in doing these analyses was to examine how well the proposal would function over several decades under a wide variety of average program growth and CBO interest rate scenarios.

By any other name, section 6 creates a formula. It does so by defining the elements that are used in calculating the interest rate, and it does so by mandating a Revolving Fund rate which will yield interest income into the Fund equal to but not greater than the interest expenses that the Fund pays on its obligations, more specifically, CBO's.

Section 6 language is given to you on page 1 of the attachment to the testimony. On page 2 there is an explanation of how we converted that language into an operable formula which we could use in our automated Revolving Fund model. Page 2 also gives you a very simple example of how the formula would be used to calculate Revolving Fund interest rates.

Exhibits 1, 2, and 3 of that attachment summarize the results of over 100 computer runs we made to simulate a wide variety of average CBO interest rate and program size combinations, again, projected over the next 50 years. The bottom line is this: Use of the section 6 mechanism or formula—whichever you prefer—will almost assuredly result in Fund insolvency if the \$7.9 billion are repaid to Treasury. The virtual absence of cases resulting in solvency, shown graphically in exhibit 2, attest to the fact that this is a formula which is destined to fail, either by accident or by design, if the \$7.9 billion is repaid.

However, even with the elimination of the \$7.9 billion long-term note debt, even with the requested refinancing of CBO's, our analysis indicates that the Fund will probably still go insolvent, and, in fact, will go insolvent under most of the plausible combinations of CBO interest rate and program growth. That is shown in exhibit 3.

The charts behind me demonstrate what happens to Revolving Fund rates and net note receivable amounts under 2 of the 100-plus simulations which we have run. This chart provides data on net notes receivable—net notes receivable defined as the gross notes receivable to the Fund, minus any CBO's which are outstanding at the current time. You will note that over the past 10 years, since the onset of the Revolving Fund, we have gradually increased the size of net notes receivable—net notes receivable being a good general indicator of the strength, the vitality, the viability of the Fund.

What you see here are four different types of cases, what could happen to the Fund, to the net notes receivable, over the next—in this case—30-some years. The green line reflects what happens if no legislation is enacted. This assumes a straight 5-percent standard rate for the Revolving Fund, an 11-percent CBO rate, a \$1.1 billion program with no growth, no forgiveness or refinancing of CBO's, and the amortization of existing CBO's.

As you can see, the net notes receivable peak within the next couple of years and then begin a steady and increasingly steep decline to zero by the year 2002. By our reckoning, at the point when net notes receivable equals zero, REA will have to come to Congress and receive some type of appropriation or additional assistance in order to continue a loan program at whatever level is specified in the assumptions—in this case, \$1.1 billion per year.

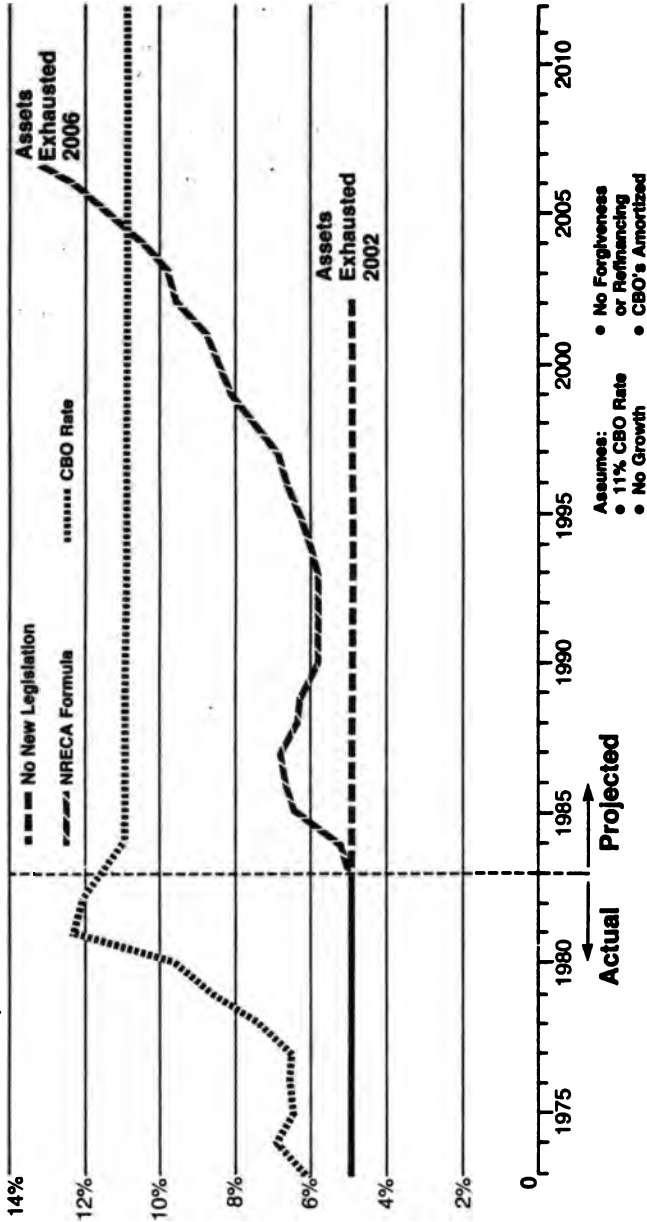
By contrast, we have an example of something Mr. Hunter alluded to earlier in his testimony. That would be setting a Revolving Fund rate equal to about 2 percent below the CBO rate. Right now the CBO rate is about 11 percent. Thus, we would set a Revolving Fund rate at around 9 percent; and the net notes receivable, under this particular option, would hold fairly steady despite repayments of the long-term Treasury notes. In fact, by the end of 2012, where this chart ends, we would have essentially the same amount of net notes receivable as we have now. The Fund would be on very solid, very secure financial footing.

The solid red line indicates what would happen if we institute only the H.R. 3050 formula. It does not assume any forgiveness of long-term notes. It doesn't assume any CBO refinancing. What the formula buys the Fund is about 4 more years of solvency. There will be a few more years when the net notes receivable would increase, and then again a steep decline to zero by the year 2006.

The dashed line represents a little different case. The dashed line, in fact, would be equivalent to the complete enactment of H.R. 3050. It assumes the full forgiveness of the \$7.9 billion in long-term notes. It assumes downward-only refinancing of CBO's. It assumes that we would use the mechanism or the formula that is contained in section 6. What happens under this formula is that while net notes receivable remain at approximately the same levels for 7 years, a dynamic takes place that eventually drives the Fund to insolvency beyond the end of the chart, in 2017.

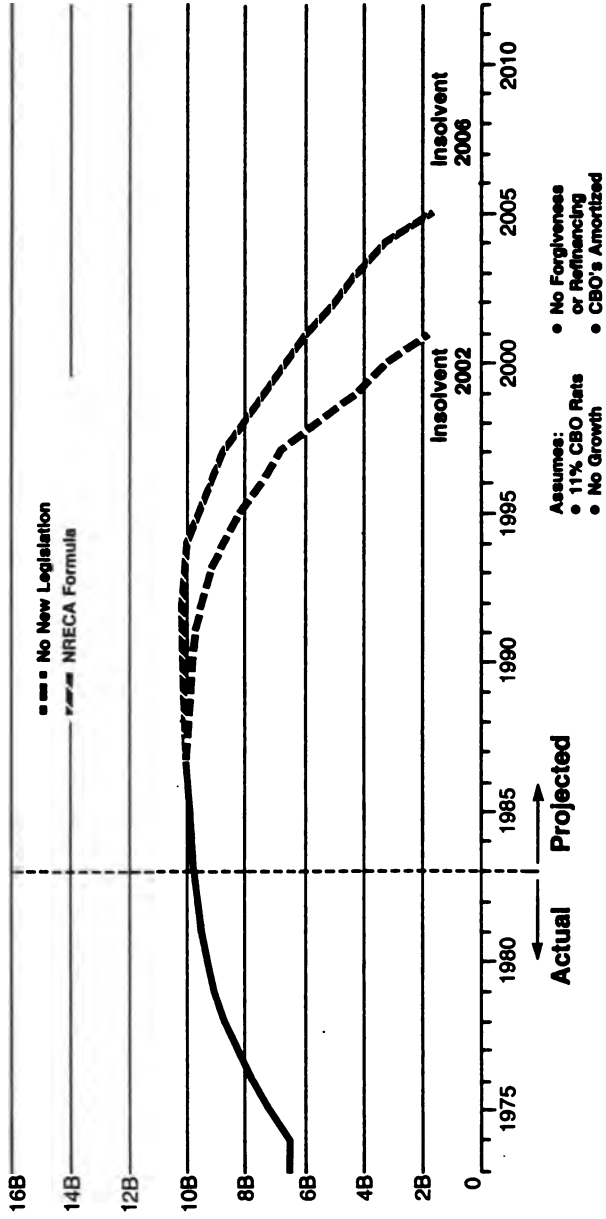
[The attachments follow:]

RETRF Standard Rates



RETRF Net Notes Receivable

(Gross Notes Receivable Minus CBO's Outstanding)



NRECA Proposed Formula
Section 6 of H.R. 3050

ABSTRACT

Section 6 of the proposed bill would amend Section 305 (b) of the Rural Electrification Act to include a specific method for determining "standard" interest rates charged to Rural Electrification and Telephone Revolving Fund (RETRF) borrowers. This bill concentrates on increasing interest rates charged to RETRF borrowers, and purports to establish a method or formula which will assure the self-sufficiency of the Fund. Unfortunately, our analyses demonstrate that the method proposed in the bill will not work under program level and cost of money assumptions resembling those of the past several years. Even given a other forgivenesses requested in the bill, the NRECA proposed formula would result in the total depletion of Fund assets in a matter of years. Simply put, the NRECA method proposed in the bill would result in RETRF interest rates which are early too low to balance the Fund, rates which in fact are substantially lower than those which NRECA itself determined were necessary in their initial analyses.

This proposed method would also have the effect of changing the entire character of the revolving fund. Despite recent reliance on Certificate of Beneficial Ownership (CBO) sales to support the loan program, the Act amendments of 1973 envisioned an RETRF which would operate under traditional revolving fund concepts. The new loan advances generally balance loan receipts. The bill's method would institutionalize continued and expanding CBO sales as the primary mechanism for funding loan advances. RETRF rates would be artificially suppressed such that the Fund would be unable to function without CBO sales. We see no rationale for using a method which will make the RETRF dependent on perpetual CBO sales when other methods are available which would assure continued adequate levels of RETRF funding at rates which are below the Government's cost of money.

SUMMARY OF ANALYSES

Using REA's RETRF model we examined how the RETRF would operate given the NRECA proposed formula. This formula is as follows:

"the standard rate for each account shall be that rate, not less than 5 per centum per annum, that would produce, from loans (other than special rate loans) approved from that account during a given period, interest income equal to, but not greater than, the amount of anticipated interest expense on the account's obligations (interim notes insured notes and certificates of beneficial ownership) required to be issued or sold during such period to cover loan advances and interest expenses: Provided that the amount of such obligations to be issued or sold for such purpose shall be determined by deducting the sum of principal and interest receipts and any appropriation under subsection (c) of this section from the sum of loan advances and interest expenses on outstanding obligations of the account during such period."

Reducing this formula to mathematical terms, it would be calculated as follows for each period:

REA Interest Rate =

$$\frac{(\text{Loan Advances} + \text{CBO Interest Expense}) - (\text{Borrowers' Loan Payments})}{\text{Loan Approvals}} \times \text{CBO rate}$$

Example:

Expected 1984 Advances = \$1.1 Billion
 Anticipated 1984 CBO interest expense = \$400 Million
 Principal and interest payments from borrowers in 1984 = \$910 Million
 Loan approvals anticipated for 1984 = \$1.1 Billion
 Presumed CBO rate = 11 %

$$\frac{(1.1 + .4) - .91}{1.1} \times .11 = .059 \text{ or } 5.9\%$$

The impact of this proposed formula was analyzed for numerous cases.

Exhibit 1 summarizes the results of our analyses for several of the principal cases we examined.

Note from Exhibit 1 that:

- a. The NRECA formula does not produce fund solvency except in cases which appear unrealistic, such as zero program growth and an 8% CBO rate for the indefinite future.
- b. Amortization of CBOs does not result in fund solvency under NRECA's formula.
- c. REA interest rates remain far below the CBO rate for most cases; such low rates are the cause of Fund insolvency.
- d. Under NRECA's proposed formula the RETRF would continue to depend on increasing levels of CBO sales to support the REA loan program.

Exhibits 2 and 3 highlight the fact that the NRECA proposed formula will produce Fund solvency in only a few situations--situations unlike those we've seen in recent years or perhaps are likely to see in the future.

A further problem with the NRECA proposed formula is that it is based on an annualized approach. That is, interest rates for each period are based on expected activity for that period. Thus, if advances or approvals are expected to increase or decline substantially during a given period this could have a profound impact on REA interest rates. The fact that the proposed formula is based on an annualized approach (which could lead to drastic swings in rates) means that it could also be manipulated such that it produces unreasonably high or low rates.

As shown earlier, the NRECA proposed Section 6 formula would not result in Fund solvency, however, it is an example of an annualized approach. Thus it is used in the examples below to show the range of REA interest rates that could occur during FY 1984 using an annualized approach.

REA Interest Rate Calculation for Six-Month Period

<u>REA Interest Rates</u>	<u>Advances</u>	<u>CBO Interest</u>	<u>Loan Repayments</u>	<u>Loan Approvals</u>	<u>CBO Interest Rate</u>
6.5 =	((550	+200	-450)	+ 550)	x 12.0%
7.7 =	((700	+200	-450)	+ 700)	x 12.0%
3.1 =	((450	+200	-450)	+ 700)	x 12.0%
9.0 =	((700	+200	-450)	+ 550)	x 12.0%

Conclusion

The proposed Section 6 interest rate formula is technically and conceptually flawed in several major ways:

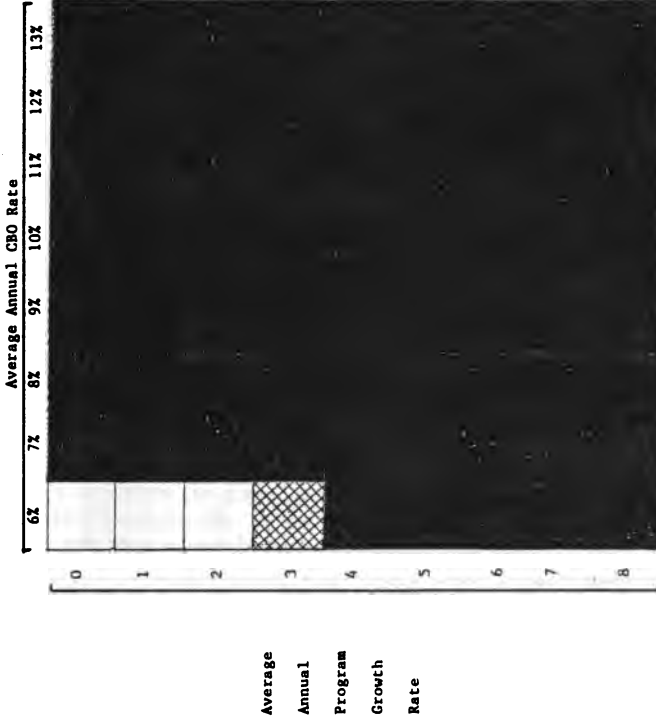
- a. It simply does not work, i.e., it does not produce adequate interest rates to result in Fund solvency.
- b. It would increase RETRF dependence on funds from Treasury in the form of ever increasing CBO sales.
- c. It is based on an annualized approach which can result in drastic swings in REA interest rates from period to period based on the levels of advances and loan approvals and/or the administration of this formula.

IMPACT OF MRECA PROPOSED FORMULA, SECTION 6, H.R. 3050

MRECA Requested Subsidies Long-Term Note Forgiveness	CBQ Refinancing (Downward Only)	CBQ Interest Rate	CBQ's Amortized Interest	Yr. During Which: Interest Exceeds Program Growth*	Appropriations Needed	REA LOAN INTEREST RATE												CBO's OUTSTANDING \$ in Billions		
						1985		1990		1995		2000		2010		2020		1985	1990	1995
						5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.0	6.9	8.3	
yes	yes	8	yes	0	0.0	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.0	6.9	8.3	8.6	4.7	-8.0	
yes	yes	8	no	0	0.0	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.0	6.9	8.3	8.6	4.7	-7.9	
yes	yes	8	yes	6	2001.5	5.00	5.00	5.00	5.17	6.29	7.09	4.0	7.6	11.9	18.6	43.4	95.6			
yes	yes	8	no	6	2001.5	5.00	5.00	5.00	5.17	6.29	7.10	4.0	7.6	11.9	18.6	43.4	95.6			
yes	yes	11	yes	0	2017.0	6.06	5.45	5.40	5.51	6.25	9.83	4.1	7.6	10.3	13.0	18.9	25.7			
yes	yes	11	no	0	1991.5	6.23	5.72	5.68	5.77	7.70	9.29	4.1	7.7	10.6	13.4	19.6	25.9			
yes	yes	11	yes	6	1992.0	6.10	6.84	7.94	8.78	10.04	9.90	4.1	8.3	13.8	22.2	51.7	103.3			
yes	yes	11	no	6	1990.5	6.27	7.04	8.08	8.87	10.12	9.86	4.1	8.4	14.1	22.5	52.3	103.4			
no	no	8	yes	0	1996.5	5.00	5.00	5.00	5.00	5.38	5.00	4.1	7.6	10.4	14.2	23.6	25.0			
no	no	8	no	0	1995.5	5.00	5.00	5.00	6.51	5.00	4.1	7.6	10.4	14.3	24.6	25.0				
no	no	8	yes	6	1992.5	5.00	5.00	5.62	6.50	7.12	6.80	4.1	8.4	14.0	23.9	54.9	99.3			
no	no	8	no	6	1992.5	5.00	5.00	5.67	6.58	7.19	6.78	4.1	8.4	14.1	24.1	54.9	99.3			
no	no	11	yes	0	1990.0	6.43	5.94	6.32	8.54	9.73	6.86	4.1	7.8	11.2	16.4	25.7	27.1			
no	no	11	no	0	1988.0	6.61	6.23	6.63	8.87	9.76	6.69	4.2	8.0	11.4	16.8	25.7	27.2			
no	no	11	yes	6	1989.5	6.47	7.20	8.45	10.00	10.22	9.64	4.1	8.6	14.7	25.5	57.0	104.3			
no	no	11	no	6	1987.5	6.64	7.41	8.61	10.12	10.23	9.62	4.2	8.7	15.0	25.9	57.1	104.5			

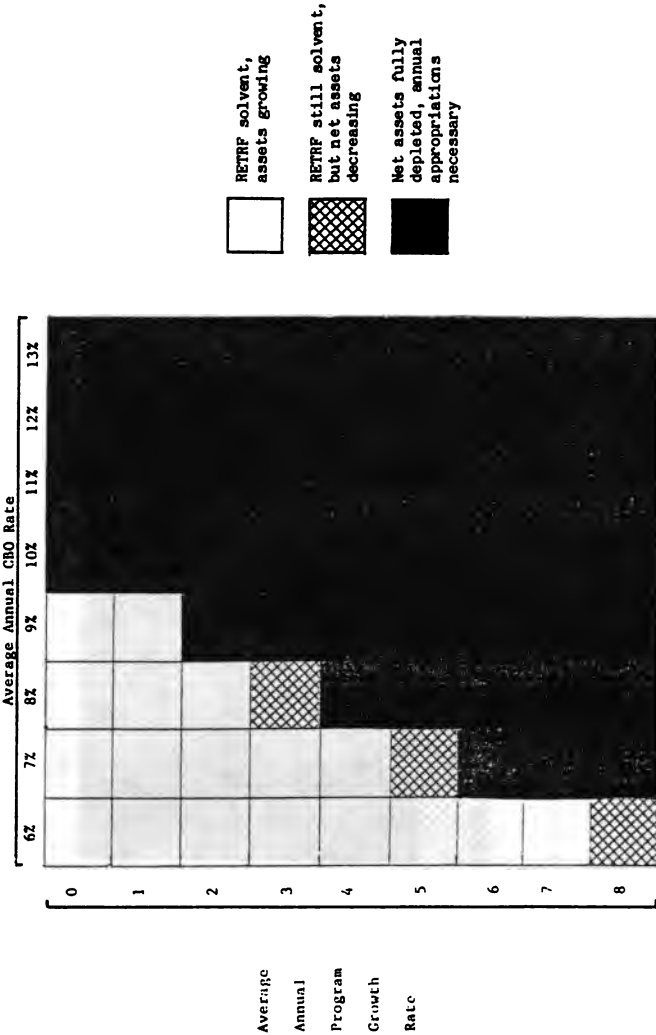
* Beginning with a 1984 program of \$1.1 Billion (9850 electric and 250 telephone)

RETRF STATUS IN 2032 USING NRECA-PROPOSED FORMULA



Assumptions: \$1.1 Billion program in 1984
 Full repayment of long-term notes when due
 No refinancing of CBO's

RETRF STATUS IN 2032 USING ABECA-PROPOSED FORMULA



Assumption: \$1.1 Billion program in 1984
 Full forgiveness of \$7.864 Billion in long-term notes
 Downward-only refinancing of CBO's

Mr. COLEMAN. Mr. Belluzzo, that top line—excuse me—I am unsure exactly what the premises are on the top line.

Mr. BELLUZZO. The blue line, the top line premise—

Mr. COLEMAN. Is it blue or green? I can't see.

Mr. BELLUZZO. The top line premise is that the Revolving Fund rate would change from its current 5 to 9 percent.

Mr. COLEMAN. A steady 9 percent?

Mr. BELLUZZO. A steady 9 percent, and of course that assumes an 11 percent CBO rate for the next 35 years.

The second chart is fairly simple and straightforward. It reflects what types of rates would be generated under these different options. As you can see and as you know, over the last 10 years we have had a straight 5 percent rate represented by this dashed line. At the same time the CBO rates have varied fairly wildly, reaching a peak over 12 percent, and now are settling back down to about the 11.5 percent level as of yesterday's fixing.

If there were no legislation, obviously the rates would stay at 5 percent and the Fund would exhaust its assets by 2002. Under the option where we would set the rate at within about 2 percent of the CBO rate, the rate would go up to 9 percent and would stay there. The Fund would not go insolvent for the foreseeable future. As far as our model will take us, the Fund retains its solvency.

The solid line represents the same case as on the previous chart, where all we are doing is inserting the formula or the mechanism which is enclosed in section 6 of the proposed legislation. As you can see, the rates that are established go up a little bit early on—and some of this is a result of some technical assumptions we used—and eventually settle down below the 6 percent level for several years, until the 1990's, when according to this assumption the long-term notes become payable. At that point the rates begin to rise very rapidly, and spike up over the CBO rate, coincidental with the time when the assets of the Fund are depleted. Then, by a strange mechanism of the formula, even though appropriations would be necessary to keep a \$1.1 billion program level, the rates would start to drop—the rates that the borrowers would be paying.

That is contrasted with, again, this dashed line which represents essentially full enactment of H.R. 3050: Full forgiveness of the \$7.9 billion, refinancing of CBO's. In this case the rates would stay below the 6-percent level past the year 2000. They would begin to rise as the larger CBO repayments became due. Eventually they would also spike above the CBO rate, and the assets of the Fund would be exhausted by 2017.

Mr. ENGLISH. Mr. Belluzzo.

Mr. BELLUZZO. Sir.

Mr. ENGLISH. I just want to ask one quick question. I assume that the degree you are talking about, all these figures would depend on the amount of money that is being borrowed. The less money borrowed, the less of a problem you have. Are you making your projections based on the amount of money that has been borrowed and loaned out by the REA for the last 2 or 3 years, or are you basing it on some maximum amount that should be, or could be?

Mr. BELLUZZO. Sir, this is based on a \$1.1 billion annual program that does not grow.

Mr. ENGLISH. How does that compare with what is happening now?

Mr. BELLUZZO. Over the last 3 or 4 years we have had no growth. If you want to look over the last 10 years, we have probably had 4 or 5 or 6 percent annualized growth.

Mr. ENGLISH. What is the amount of dollars, that's what I am asking?

Mr. BELLUZZO. About \$1.1 billion.

Mr. ENGLISH. OK. Thank you, Mr. Chairman.

Are you sure of that, Mr. Belluzzo? Counsel here is suggesting that you haven't loaned out \$1.1 billion.

Mr. BELLUZZO. Are you talking about approvals or advances? In advances we will put out about \$900 million this year.

Mr. ENGLISH. Therefore, this is higher than what you have been putting out. Is that correct?

Mr. HUNTER. For this year.

Mr. ENGLISH. Your projections are higher?

Mr. HUNTER. The legislation has tied us to the \$1.1 billion as being the authorized amount, and that is what we have loaned as far as the authorized loans. In some cases those moneys have not all been drawn down; the advances have not all been made.

Mr. ENGLISH. However, that is a maximum—

Mr. HUNTER. This is the electric program combined with the telephone program.

Mr. ENGLISH. Yes, but that is a maximum, Harold, under the legislation, so then the projections and chart that you have are higher or greater than the projections that you have had for the last 2 years.

Mr. HUNTER. No; this is the amount that we were authorized to loan and the amount that we did loan.

Mr. ENGLISH. You did loan that amount out?

Mr. HUNTER. Yes, sir.

Mr. JONES of Tennessee. Mr. Hunter, it appears to the members of the subcommittee that your charts differ from the charts that you presented us here.

Mr. HUNTER. We have other charts which tell the same story, but in a different format. We will be glad to provide copies of these also.

Mr. JONES of Tennessee. Well, that is what I am asking for. We would like to have the same information that you have there in order to be able to understand it a little more clearly.

Mr. HUNTER. We will provide this, Mr. Chairman. Also, we will be glad to discuss any of the details because it takes a little time to understand, to get into in-depth.

Mr. JONES of Tennessee. Several members of the subcommittee have expressed a desire to see the full charts rather than the partial charts.

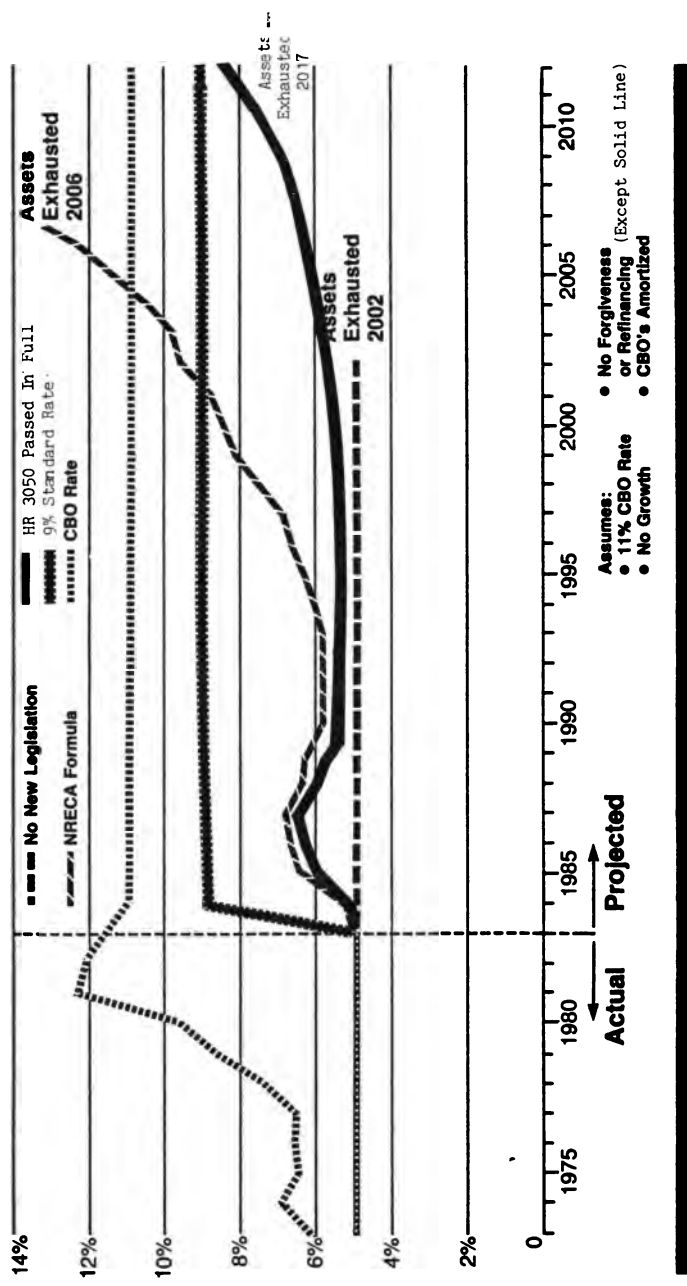
Mr. HUNTER. These charts we felt displayed our results in a visible way a little better than the charts we have in your handout. However, there is no violation between the data encompassed in that material and the data that we have in here.

Mr. JONES of Tennessee. Well, if you will provide us with your charts, we would appreciate it.

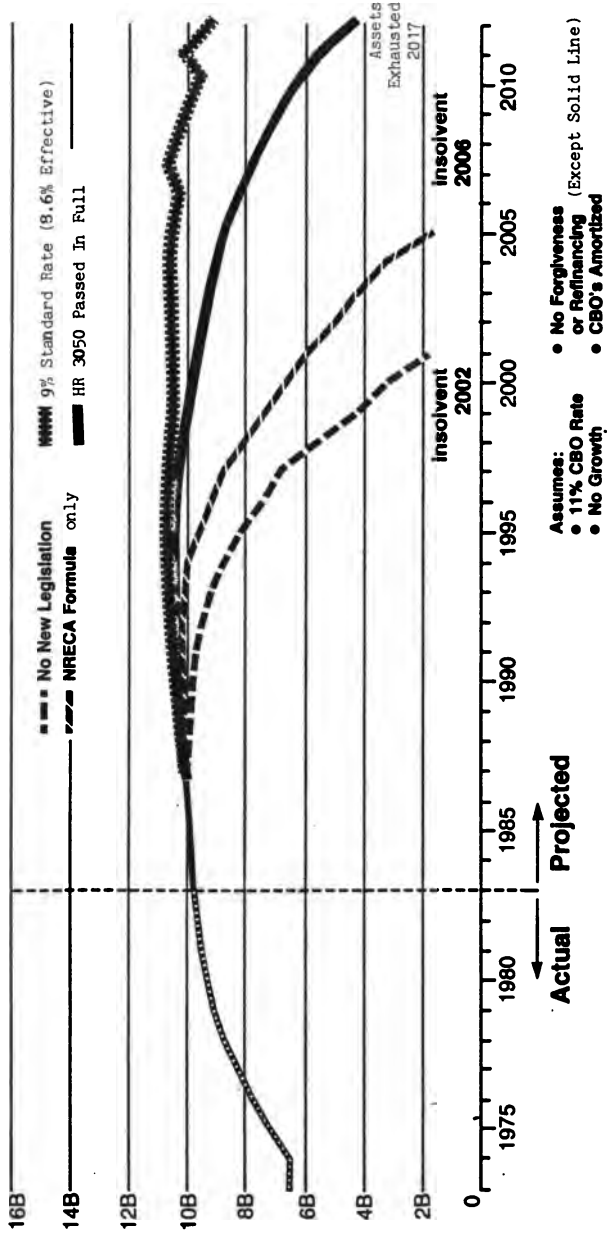
Mr. HUNTER. We will, sir.

[The charts follow:]

RETRF Standard Rates



RETRF Net Notes Receivable (Gross Notes Receivable Minus CBO's Outstanding)



Mr. BEDELL. Would the chairman yield?

Mr. JONES of Tennessee. Yes. Mr. Bedell wants to be recognized at this point.

Mr. BEDELL. How did you determine the interest rates that you used for these charts? I am just reading the bill here and, as near as I can determine, the bill does not mandate interest rates. Do I misread the bill, or how did you determine rate? It says, "not greater than," and "the Administrator may," and so on. As near as I can tell, the Administrator has significant discretion.

Mr. HUNTER. The interest rates are determined by the formula which is predicated by the language of the bill. Actually, we visited with personnel within NRECA who had arrived at that language to begin with, and that was as early as June.

Mr. BEDELL. Well, is there agreement between those people and your department that the interest rates you have used are indeed the proper interest rates to use in making these projections?

Mr. HUNTER. Can you answer that?

Mr. BELLUZZO. I cannot speak for what the trade associations feel about these—

Mr. BEDELL. You said you met with them. Did they agree with you or did they disagree with you.

Mr. BELLUZZO. We met with them in May. My feeling was that they understood what our problems were, what our concerns were. We walked through the printouts. We manually calculated some of the figures. I cannot speak for what was in their minds, of course.

Mr. BEDELL. All right. Thank you.

Mr. BELLUZZO. Exhibit 1, also in the attachment, provides some detailed information on 16 of the 100-plus runs that we did. In fact, you will find these particular cases included in the exhibit 1 detail. That detail shows some representative interest rates and it shows the amounts of CBO's outstanding at various points of time under a variety of different assumptions.

You will note, by the way, that half of those cases have been run using an amortization of CBO's that has a slight salutary effect on the Fund, but essentially it has no real impact on the speed or the certainty with which the Fund goes insolvent.

We also have the hard copies of the computer printouts that we used. We have a little sheet that describes how to decipher those particular printouts, for anybody who is daring enough to want to try to work through that. It explains the assumptions that we have used. I am certainly willing to explain that to anyone. The question of assumptions is fairly important. We had to make certain assumptions about how the formula would work in practice.

Mr. JONES of Tennessee. Can you make that available to the subcommittee?

Mr. BELLUZZO. Absolutely.

Mr. JONES of Tennessee. We need it as quickly as possible because we are ready to mark up a bill, and we need to have that as soon as possible.

Mr. BELLUZZO. Certainly. We brought it with us today, sir.

Mr. STENHOLM. Mr. Chairman.

Mr. JONES of Tennessee. Mr. Stenholm. We are all going to get a chance to question in just a moment.

Mr. STENHOLM. Later? OK.

Mr. JONES of Tennessee. Go ahead, if you have something you want to say.

Mr. STENHOLM. No, I'll wait.

Mr. JONES of Tennessee. Mr. Belluzzo, you may proceed.

Mr. BELLUZZO. Thank you.

Page 3 of the testimony attachment also describes, for your information, the wide range of rates that one can get, depending on how poorly one estimates some given element of the Fund, of the formula, or how consciously one wants to manipulate the rates upward or downward. That is essentially an inherent flaw in any semiannual or annually based formula such as the one proposed in the section 6 mechanism.

In summary, gentlemen, as we view it from an analytical standpoint at least, the language of section 6 creates a formula. We are as confident as we can be that the formula we have used in our modeling is an accurate representation of what was intended or what is intended in the H.R. 3050 language, particularly—as Mr. Hunter mentioned—since we have discussed our interpretation of the language with staff from the trade associations. As a general rule, gentlemen, that formula fails to result in Revolving Fund self-sufficiency for the simple reason that it fails to set Revolving Fund rates high enough, early enough.

Mr. HUNTER. Mr. Chairman, we will leave that subject for just a moment. We need to speak about the guarantees themselves. The 1973 act envisioned interest rates on loan guarantees and CBO's which would reflect the rates paid by the Federal Government for Treasury borrowings of comparable maturity. Recent high interest rates have resulted in correspondingly high CBO rates, and may result in some high-rate loan guarantees.

The bill before us provides for penalty-free, one-way, downward-only refinancing of CBO's and loan guarantees. The only types of situations where these provisions do not result in increased costs to the Government are where the Government's cost of borrowing rises to 15 percent and remains there indefinitely. In any case where interest rates follow a downward trend or a more traditional cyclic pattern, the cost to the Treasury of these refinancing provisions will be far greater and more immediate than the forgiveness of the \$7.9 billion in long-term notes.

Another major problem with the proposed legislation relates to changes in REA lien accommodation and subordination policies. Those changes could essentially require REA to subordinate its liens for virtually any reason requested by the borrower. We believe that our primary fiduciary responsibility is to assure the security of loans that we make. We also believe that we should not allow our security to be diluted by subordinating or accommodating our lien to support ventures not otherwise fundable under the act.

Another major problem is the requirement that REA guarantee third party the National Rural Utilities Cooperative Finance Corporation, or CFC, debt. This provision will only make cooperatives more reliant on Federal Government credit guarantees. Further, since States and municipalities are eligible borrowers, the language in section 7 of the bill would be interpreted to require REA loan guarantees for tax-exempt obligations such as municipal or State bonds. According to the U.S. Treasury, Congress has enacted some

24 statutes which preclude Federal guarantees of tax-exempts since 1970. Therefore, we strongly oppose this provision.

Quite frankly, we believe that the framers of the bill did not in all cases realize the true extent of the giveaways and the forgivenesses contained in those provisions; the costs of those giveaways and forgivenesses to the Government and to taxpayers and to future generations of rural electric and telephone consumer/subscribers; and the extent to which this legislation makes the borrowers look like they are seeking an unwarranted, extremely costly handout.

The major effort of our testimony before you this morning is for the purpose of clarifying and identifying what this bill actually does. There is major confusion about it. I find this to be true in many areas. Some of that confusion relates specifically to the notes that we have discussed, that have been referred to earlier in other testimony, and I would like to take just one moment and somehow graphically show a little bit of the difference that is involved and what sometimes is thought about regarding these particular notes.

Let us assume that my microphone is REA. Let's also assume that these cups sitting here—and I shouldn't have put them upside down, that doesn't infer too well, let's put them right side up—that those cups are REA borrowers. Let's think about the borrowing, the lending, the negotiation that takes place between our borrowers and REA. Our borrowers have a tremendous reputation. It may be unique in Federal Government that less than \$50,000 has ever been forfeited in the 48-year history of this great agency.

Our borrowers repay their debts, which consist of notes that exist here. But those are not the notes that we are talking about when we talk about forgiving \$7.9 billion. Put that completely out of your minds, if you will. The notes we are concerned with are those notes that are owed by REA—this entity sitting up here in the middle of all this action—to the U.S. Treasury. They are real notes. They consist of some 38 legal documents, each one of them a signed document representing so many dollars that come due on a certain date, beginning 1993 and ending in 2016.

These notes represent the negotiations that took place between REA and its financier, the U.S. Treasury; which represents this country—not just rural America, but the country as a whole. These were not moneys that were appropriated. These were moneys that were loaned to REA. That is on the record. Everything we are bringing to you is factual because we think that you need facts; you need a true understanding of what this legislation does in order to consider it.

I am convinced that we need legislation. I agree completely that we need to deal with the needs of the REA Revolving Fund in the future. But we need to do it in a knowledgeable way so that we don't again—as was done in 1973, very innocently—set up dynamics that didn't work. There was no flexibility in the interest rate to accommodate the unforeseen radical increase in the cost of Treasury borrowing.

We believe that when one considers the value of the many Federal benefits already provided to cooperatives—subsidized direct loans, 100 percent loan guarantees, tax-exempt status, tax-exempt municipal bonds for pollution control equipment, incentives for

safe-harbor leasing, even though most cooperatives have been tax-exempt, and preferential access to low-cost Federal power—the proposal before us represents a major increase that is neither justified nor consistent with the goal of the 1973 Rural Electrification Act calling for greater borrower reliance on private credit.

This proposal is an overreaction to a potential future problem; a real problem in the future unless something is done with the Fund. Therefore, we strongly oppose the legislation as it is written. We appreciate this opportunity to be heard by your committee and by you, Mr. Chairman. Naturally, we would be pleased to answer any questions, and bring any further enlightenment to the bill that we can.

[The prepared statement of Mr. Hunter appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Hunter and Mr. Belluzzo, Frank, Mr. Van Mark.

Governor Olson, if you will come back to the witness table now, we will give an opportunity to the members of the subcommittee for questioning. We will do it all at one time.

Did the Governor leave? Well, we will proceed with the witnesses we have.

We will be under the 5-minute rule so everybody will get an opportunity to ask questions. The Chair yields to Mr. Coleman, the ranking minority member of the subcommittee, for 5 minutes.

Mr. COLEMAN. Mr. Hunter, on page 3 you indicated—I believe in answer to a question that I asked Mr. Belluzzo to clarify—that the assumption is a 9 percent constant interest rate, an increase to 9 percent. Is that based upon combining telephone and electric borrowings? Mr. English was asking a question about the growth, and that combines the two, so—

Mr. HUNTER. The \$1.1 billion we refer to as the level of the program does combine both electric and telephone.

Mr. COLEMAN. Your 9 percent, which is that constant line there on your chart, is more than a break-even point; is it not?

Mr. HUNTER. That is right. Incidentally, to clarify, that 9 percent is an assumption. Assuming that the CBO rates stay at 11 percent, that would trigger a 9-percent level, which is within 2 percentage points of the cost of Treasury borrowing. Actually, the rate will vary up and down, but for this display and demonstration we assumed that that level of interest on Treasury borrowing stayed at that 11-percent level.

Mr. COLEMAN. Now on page 2 of—I am not sure what you call this, but it is after your charts and your testimony, when you talk about the formula—you come up with a 5.9-percent figure. Maybe Mr. Belluzzo wants to answer this. I am not sure. What does that represent, the 5.9 percent?

Mr. BELLUZZO. It is only an example, as it states right there.

Mr. COLEMAN. An example based upon today's reality?

Mr. BELLUZZO. An example based on what we think the loan activity is going to be in 1984, \$1.1 billion; an anticipated CBO interest rate of about 11 percent; anticipated CBO interest expense, which is something we can estimate very closely at about \$400 million.

Mr. COLEMAN. What do you anticipate there or what is part of that formula as far as the borrowing fund interest rate? Is that at 5 percent or as under the bill?

Mr. BELLUZZO. The whole point of this little formula is to demonstrate how you would use these various factors, these elements as they are described in the legislation, in section 6, to derive the formula.

Mr. COLEMAN. All right, so we come out with a 5.9-percent borrowing?

Mr. BELLUZZO. Yes, sir.

Mr. COLEMAN. Is that a break-even figure?

Mr. BELLUZZO. No, not at a \$1.1-billion level, program level, over any number of years.

Mr. COLEMAN. Is that part of your declining chart, then? It is not a break-even figure; it is too low, you say.

Mr. BELLUZZO. Yes.

Mr. COLEMAN. Nine percent would be the break-even figure.

Mr. BELLUZZO. Well, not exactly 9 percent. I think the rate that we used up here—excuse me—is an 8.6-percent effective rate. This would be the standard rate that we would charge most borrowers. There would be, as in the past, some amount of discretionary loan activity which would bring down the effective interest rate, the total, melded rate that we are charging the borrowers.

Mr. COLEMAN. We need truth-in-lending here for this committee, I think. [Laughter.]

I just want to make sure I understand that your 9 percent that you suggest as the answer to this problem is not the same as the break-even point of your 5.9 under current circumstances. They are different. They are not the same break-even points.

Mr. BELLUZZO. That is correct.

Mr. COLEMAN. Do you know what the impact of a 9 percent borrowing rate would be upon consumers? What is the impact to the local consumer?

Mr. HUNTER. Mr. Coleman, that would vary, naturally, with the borrower, with the system it was applied to. However, there is a rule of thumb that we have come to recognize as applying in most cases, and that is that for every percentage point increase in the interest rate being charged, you will see an increase to the borrower out at the end of the line of approximately half a penny a day.

Mr. VAN MARK. That is the residential consumer.

Mr. HUNTER. Yes, on the residential consumer.

Mr. COLEMAN. Now you testified that you recognize there is a problem here. I mean, all your charts and graphs and information indicate that, and yet I have not received any proposals from the administration. You knew about this problem. Why don't you propose something to do something about it?

Mr. HUNTER. We felt that our responsibility here in this hearing was to address ourselves to the legislation that is before you. We have tried to analyze the capabilities of that legislation to deal with the problem.

We have pointed out that a greater escalation or increase in those interest rates is needed to assure the longevity and the effectiveness of the Fund. We have addressed ourselves to philosophical,

conceptual answers or suggestions rather than to legislation at the present time.

I will be frank with you. The administration has not agreed upon a legislative package at this time.

Mr. COLEMAN. Mr. Chairman, I see my time is up. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman.

The Chair recognizes Mr. Stenholm for questioning for 5 minutes.

Mr. STENHOLM. I want to go back to the chart and, Mr. Belluzzo, your interpretation of section 6 on page 5. I read this, and I will just read it straight out of the bill:

Such rules and regulations shall provide that the standard rate for each account shall be that rate not less than 5 per centum per annum that would produce from loans, other than special rate loans, approved from that account during a given period, interest income equal to but not greater than the amount of anticipated interest expense on the account's obligations, interim notes, insured notes, and Certificates of Beneficial Ownership required to be issued or sold during such period to cover loan advances and interest expenses.

Now when I read that, I don't get the same interpretation that you showed us on the chart that you have here, which we don't have in the testimony that you provided. Therefore, would you go back over that again to try to explain to me how this language is going to produce that rate, or what interpretation of this language, Mr. Hunter, would give those results.

Mr. HUNTER. Can you touch on the technicalities on it, and then I will touch on the general?

Mr. BELLUZZO. OK. As you properly read the language, and as you can tell from the language, it specifies the types of elements that will be considered in calculating the Fund. It says the Administrator may set rates at such-and-such levels but then it goes on to describe, in fairly specific detail, the elements that will be used in setting the interest rate.

It describes in very specific detail what that interest rate is to accomplish. The interest rate is to accomplish the receiving of interest amounts equal to but not greater than the amount of interest expense that the Fund will incur through the sale of CBO's, essentially. That is basically what we are talking about.

You can look at that in only a couple of different ways from a mathematical standpoint. Eventually you have to reduce this type of language to a mechanism, to an approach that you would use administratively to set what those interest rates are, to assist the Administrator in deciding what kind of rate to set up for a given period of time. The way you do that is to attempt to reduce it to a formula. Sometimes you cannot make a formula out of a piece of legislative proposal.

In this particular case, if you look at it and you look at the way the various components fit together and are stated here in this section, you end up with a formula. You end up with a formula which is intended to produce interest on the money that we lend out from the Fund equal to the interest expense that the Fund incurs in its sale of CBO's.

Mr. STENHOLM. Are you assuming the 5 percent is a ceiling or a floor?

Mr. BELLUZZO. It is a floor, absolutely, a floor. That is what it says.

Mr. STENHOLM. Your explanation sounds like you have assumed in your chart that it is a ceiling; that it is not to be adjusted in the same manner that you are suggesting in the legislative proposal that you don't have to make to us today.

Mr. BELLUZZO. I'm sorry. I am not following the point. The rates that are generated by the use of this formula—

Mr. STENHOLM. This chart, right here.

Mr. BELLUZZO. Right. These rates are the rates that are generated when you apply the formula contained on the next page to a \$1.1 billion program that doesn't change in size over the years, assuming an 11-percent CBO rate. Those are the rates you get when you apply this formula to those numbers.

Mr. STENHOLM. OK. I think I am going to have to study your testimony and your explanation that you have a little bit more. I just don't follow you.

Mr. HUNTER. Mr. Stenholm, I believe you will note that the interest rate that is indicated on the chart is more than 5 percent, so this does generate an interest rate of more than 5 percent as we see it. However, we don't think it is sufficiently more than 5 percent to meet the long-term needs of the program.

Mr. BEDELL. Would the gentleman yield?

Mr. STENHOLM. I would be happy to yield.

Mr. BEDELL. I think the gentleman is talking for all of us. If the law says that he is supposed to charge interest rates equivalent to cover all the interest expense, then it would appear to us that the formula would be such that it would cover the interest expense. Apparently you have some complex formula that says that it would not. We need to know why that discrepancy exists, I think.

Mr. HUNTER. I think the discrepancy relates to the fact that there are other expenses that the Revolving Fund is responsible for, other than merely paying the interest expense.

Mr. BEDELL. Oh.

Mr. STENHOLM. However, is there anything in this language that would preclude that other expense from being charged and figured into an interest?

Mr. HUNTER. I believe there is.

Mr. BELLUZZO. The definition of obligations is very specific, further down in the language, very specific in terms of what you can consider and cannot consider in setting the interest rate. For example, the definition of obligations does not provide for principal repayment—on CBO's, that is. It does not provide for repayment of the long-term notes. It gives a specific definition of obligations, a limited definition of obligations.

Sir, the formula that is derived does eventually yield—if you amortize CBO's—interest income which matches interest expense, almost to the dollar. However, the problem is that while that sounds good conceptually, when you actually model it out, when you apply it to the existing condition of the Fund, the mere breaking even on interest rates is not sufficient to halt the deterioration of the net notes receivable of the Fund.

We are not starting all over with a brandnew Fund today in 1983, fiscal year 1984; we have some large amount of obligations

that we are carrying forward from the past. They are fairly expensive obligations, and unless you do something to begin to address those older obligations, simply collecting enough money to match interest expense in the future does not pull the Fund around rapidly enough.

I can understand the concern you have. Conceptually, if interest paid matches interest received, one would think that that will rally the Fund. It doesn't work that way in practice, when you plug the numbers into the Fund in the context of 10 years of obligations which the Fund has already incurred.

Mr. STENHOLM. Mr. Chairman, our time has expired. I have some additional questions I hope I will get after everyone else has had their opportunity, but I just want to point out that the language to me is very clear as to what we intend by this bill. The interpretation of the computer model is different from this, and I think we need to focus on that.

Mr. JONES of Tennessee. Thank you, Mr. Stenholm. I think your message is real clear.

The Chair now recognizes Mr. Skeen for 5 minutes.

Mr. SKEEN. Thank you, Mr. Chairman.

I was very interested in the model that you had with the cups and the microphone and the pitcher over there.

Mr. HUNTER. I felt that this was very sophisticated, Mr. Skeen.

Mr. SKEEN. I like those sophisticated illustrations. I understand them.

What bothered me about the illustration, however, was the fact that that consumer over there is the one that is eventually going to have to pay this if it is not forgiven, and there is \$7.9 billion of indebtedness that has been incurred. My question is, why has there not been any attempt between Treasury and REA to do something about this before it got into the position that it is in now, if the consumer has been paying and doing their part? Evidently there is some interpretation in the way the law has been administered. I would like some comment on that. Then I have one other question and I will leave you alone.

Mr. HUNTER. Mr. Skeen, the first problem was created by the failure to anticipate that interest rates would rise so much higher than that 5-percent level. The 5-percent interest rate is set by law, by statute, so REA cannot address that.

Mr. SKEEN. Therefore, as Mr. Belluzzo says, it is a floor, then.

Mr. HUNTER. It says it is the amount that will be charged, by law, by the definition we must live with.

Mr. SKEEN. That is the problem.

Mr. HUNTER. The other two things that would be an approach—one would be to reduce the level of the program. I know this sounds controversial but, again, we know—we don't guess, we know—that there are additional moneys available for our borrowers in the private sector. They would cost somewhat more but, again, that would be in the interest of the long-term viability of the Revolving Fund.

The second thing is that until only about 2 or 2½ years ago REA could have addressed the adjustment of our ratios and criteria by which these loans are made. But at that time there was language added to the appropriation bill which denied REA the opportunity,

the privilege of making any adjustment in the ratios and criteria which determine how those loans will be divided and allocated.

These are opportunities or options which would have been ours, but they were denied to REA as a route that we might pursue.

Mr. SKEEN. Therefore, what you are saying is, you have been stymied by your statutes involved with the administering of these kinds of loans, and it all falls back, then, to the Congress that has not had the kind of flexibility to come forward with a solution. What we are trying to do now is approach this problem after it has generated to this point.

Mr. HUNTER. I commend the Congress for participating in the development of a vehicle which could be used to address this problem. I recognize that while the studies were going on, there was some rationale in saying, "REA, leave it alone for a while. Let our people take a look at it. Let some studies be made. Let some proposals come forth."

Now the proposal is brought forth. We are trying to help in the analysis of that proposal, and that is the purpose of our response to the committee.

Mr. SKEEN. Thank you, Mr. Hunter, but there is one last part of this debate that interests me very much. I notice that in the arguments put forth by all sides of this thing, that there have been several articles generated or several hypotheses advanced about who gets more aid, the privates or the co-ops. I would like to have your comment on those because there are some very interesting comparisons being made, and I would like to have your response.

Mr. HUNTER. I believe that you can get any answer to that, Mr. Congressman, that you want to get. There are answers given by some—

Mr. SKEEN. Depending on whose experts you have?

Mr. HUNTER. It depends on what expertise you lean upon. The calculation of the value of those comparable subsidies you speak of is not a simple matter. It can be based on various assumptions or various involvements.

Let me suggest that I leave for the committee a document which is entitled, "The Management Report." It is a clipping or a photocopy from *Electrical World* of August 1982, and it quotes a Mr. Pace. Mr. Pace agrees rather vehemently with some of the figures that would indicate that the investor-owned utilities are getting a greater subsidy.

I don't argue the point. That is not the point I am trying to make. The point I am making is that this is not a simple question that can be answered in a simple way.

We also have a document here prepared by the Congressional Research Service which, of course, answers to you folks yourselves. It addresses the question of which are the larger subsidies, the electric utilities or the rural cooperatives. Again, I would like to leave that for the committee's review.

Then I have a third item here that comes from the Office of Management and Budget. That is not a very popular word around here but, again, they have a differing position.

Therefore, this is not an easy thing to answer. I don't think it is a clear-cut issue. It depends upon which values you are going to put on which types of assistance from the Federal Government.

Mr. SKEEN. Thank you, Mr. Hunter, and thank you very much, Mr. Chairman.

Mr. HUNTER. Mr. Chairman, I request that these become a part of the record.

Mr. SKEEN. I, also.

Mr. JONES of Tennessee. Without objection, we will place them on exhibit, Mr. Hunter, rather than to make them a part of the record. Without objection, we will do that.

[The material is held in the committee files.]

Mr. JONES of Tennessee. The Chair now recognizes Mr. English for 5 minutes.

Mr. ENGLISH. Thank you very much, Mr. Chairman.

Harold, I think that is important; I think it is very important. The figures that I have with regard to investor-owned utilities with accelerated depreciation and investor tax credit show that they in effect got a subsidy of about \$3.6 billion annually, about what it is running now. As far as publicly owned utilities, on tax-exempt bonds they are getting a subsidy in excess of \$330 million.

I think it is very important because the question is whether we are going to treat the REC's equally. I think that unless we are willing to wipe out those benefits for those two areas—for public utilities as well as for the investor-owned utilities—obviously there is a tremendous inequity. I think there has been an image created that it is the REC's that are getting all the benefits. That is where it all comes down, and I think that it is very important to make the record clear in that particular case.

The words you mentioned throughout your testimony, Harold, were forgiveness and giveaways. Those are big, big terms, and they certainly conveys, contrary to this image, that the REC's are getting all the benefits. Is it your understanding that this proposed legislation in effect tells the REC's they don't have to pay back this \$7.9 billion that is mentioned? They don't have to pay the Government that money?

Mr. HUNTER. Absolutely not, Mr. English. That is the purpose of my going into my very crude demonstration here of where the borrowings take place between REA and the rural electric co-ops. Certainly the co-ops have an admirable record, and I think they will continue to have that record. They believe in paying their debts, and I think that is going to happen.

However, we are talking about loans that are not those loans. The loans that I am speaking of, and that are referred to in this bill—the \$7.9 billion—every dollar of that was borrowed from the U.S. Treasury by REA, not by the borrower but by REA.

Mr. ENGLISH. That is the point I wanted to make, Harold, because I think it is critical. What we are talking about is going from one pocket of Uncle Sam's to another pocket of Uncle Sam's. They are both Government organizations, both part of the Federal Government, all a part of the administration. You are simply shifting from one pocket to the other.

The real question is, it appears to me, is it important which pocket it is in, or is the impact we might have on the ability to fulfill that great promise that we made with the formation of the REA back in the 1930's important? Are we going to be able to continue to carry out that promise?

As I pointed out in my opening statement, the U.S. Government in the last few years has placed some pretty heavy burdens on the generation of electricity, and we are getting ready to place a very heavy burden as far as telephones are concerned. Certainly the requirement in Oklahoma and elsewhere, to meet pollution standards, to provide new generating plants, is increasing this burden. In some cases it has simply gotten to the point that people cannot stand it.

What is being suggested, if I am catching the thrust of your testimony, is to go beyond that, to increase that burden, to heap even more of a problem on that user of rural telephones and rural electric, and that is where the real question comes down on what we are going to have to do on this legislation: Are we going to deal with and make a philosophical shift? Are we going to turn away from that commitment that was made in the thirties, or shall we continue to go down the line? Shall we focus upon which pocket Uncle Sam has his money in, or are we going to focus on the impact that it has upon those rural users?

Harold, with regard to this, recently in the projections you were making on some very high interest rates—11 percent or more—those are rates that are charged by the Federal Treasury to the REA, are they not?

Mr. HUNTER. That is right. Correct.

Mr. ENGLISH. Then what you are mentioning here is the rate that one Government organization is charging another Government organization.

Mr. HUNTER. What the Treasury is charging is the cost of its borrowing. Therefore, it represents the fact that they act as an agent for REA, to go to the public and private sector to borrow some money or to achieve some moneys that can be used for REA purposes.

Mr. ENGLISH. Those interest rates increased, about what period? They went up rather substantially—when—1980, 1981?

Mr. HUNTER. They went up substantially during the last 4 or 5 years. They have decreased during the last couple of years.

Mr. ENGLISH. However, 1980 is whenever the big increase took place, and the projections that you are making here are based on those higher interest rates of the last couple or 3 years, are they not?

Mr. HUNTER. They are based on the current rates, Mr. English, that REA is now paying to the U.S. Treasury. Incidentally, those rates are less than they were some year or year and a half, 2 years ago.

Mr. ENGLISH. But, the point is, the problem comes on the interest rate that the Treasury is charging the REA. That is what causes the difficulty for the REA. It is not a question of paying back the \$7.9 billion, is it?

Mr. HUNTER. The problem relates to what interest rates are in the general money market, because that determines what Treasury is paying for its money that it borrows from the private sector.

Mr. ENGLISH. Bringing that back to the private sector and comparing that to the manner in which the Federal Government is subsidizing those investor-owned utilities to the tune of \$3.6 billion a year, and the public utilities at \$331 million a year, we find that

outrageous subsidy that we are talking about here is a very small amount of \$83 million, which makes the Federal Government's subsidy to the REC's by far the smallest of any of the utility companies that we are subsidizing. Wouldn't it be more consistent, if we feel like we ought to raise interest rates, for you to come up and testify, and say, "If we are going to raise interest rates, then the Congress ought to wipe it out for everybody else, too."

Mr. HUNTER. The proper position I believe this Administrator ought to take is to pursue knowledgeability about this piece of legislation. This will assure that what we do will, in fact, continue the concepts and the thoughts and the philosophy that have been expressed by the Congresses of the past, particularly in 1973 when the Revolving Fund that we are dealing with now was set up. At that time the tenor of all of the congressional discussion, of everything that was said and that became a part of the record, indicated that the free use of that \$7.9 billion which was given to REA by the Congress at that time, was intended to create a Revolving Fund which would have the capability to perpetuate itself.

Mr. ENGLISH. I would think, Harold, that the Administrator of the REA would be far more concerned with equity and fair treatment to rural people. That is what I would think that he would be focusing his attention on.

Mr. HUNTER. I think the fairest thing that could be done for the rural people that are interested in rural electric and rural telephone service is to have a Revolving Fund which will actually function. That is our purpose in joining with you in our studies and analysis of this legislation.

Mr. ENGLISH. Thank you.

Mr. JONES of Tennessee. Thank you, Mr. English.

The Chair now recognizes Mr. Robin Tallon for 5 minutes.

Mr. TALLON. Thank you, Mr. Chairman.

I want to follow this same line of questioning of Mr. Skeen and Mr. English. Mr. Hunter, as Administrator of the Rural Electrification Administration—I think this fairness issue, and I think that is what we have been talking about, is very important to me—your opposition to the bill H.R. 3050 bothers me, quite frankly. I don't mind talking about Federal assistance, but when we look at the utilities—the municipal, the investor-owned, and the co-ops—do we have an equitable situation to protect the interest of our rural people?

I know that we are all aware of the critical financing assistance that the rural electric systems receive through REA, but don't the publicly owned utilities receive Federal assistance through tax-exempt financing, and investor-owned utilities by retaining Federal tax dollars? That is the question.

Mr. HUNTER. Mr. Congressman, I hoped I had made the point a while ago that you can look at almost any statistics you might want to, and find different conclusions. I can't help but feel that one of the best that we might look at for your purposes would be a review made by the Congressional Research Service. It is dated February 1983, which becomes about as current as anything that we can find.

Just to make a point and to read one summation, in the last paragraph it states, "As stated, the results of this analysis"—again,

made by the Congressional Research Service—"support the conclusion that rural electric cooperatives currently receive larger subsidies from the Federal Government through tax-exempt status and borrowing subsidies than the investor-owned electric utilities receive through the investment tax credit and accelerated depreciation." Therefore, I don't see it a point that we should argue because of the complexities and the difficulties of measuring the various types of assistance.

Now, then, let me also assert that personally, being from rural Oklahoma, I believe strongly that there is justification for the support through REA to the electric and telephone industries in rural America. I think it is in the best interests of this Nation as a whole. But I think we need to be out in the open, above board, and do everything we can to bring out the facts and the substance of what we are dealing with in this legislation. We must make sure that it reaches out beyond our immediate need and also takes care of the need down the road.

Now, as we analyze what has happened since 1973, it doesn't take an expert to recognize that the disparity of interest rates created the problem we are dealing with now. It becomes basic, then, to at least look at an adequate establishment of those rates to deal with that same problem.

Again, I think you would need to measure it by the impact that it has on the user at the end of the line. Certainly at the present time that user is under stress. The farmer, the agricultural industry, is in trouble, so it is not a good time to hit him. However, let's come back to this, and again I must call it forgiveness because it is a forgiveness of some specified notes that I have looked at and I have seen the list of them. The forgiveness of that \$7.9 billion does not render one iota, 1 penny of benefit to the REA or to its borrowers until the year 1993. If there is going to be an adjustment in that commitment down the road and there happens to be a need for it in 1993, why should we not leave it to the wisdom of those Congressmen at that time to deal with that option, whatever they want to pursue?

Mr. TALLON. Mr. Hunter, I feel like we need to deal with this now. We recognize we have a problem. Of course, the publicly owned utilities certainly have had the same type problems with increased interest rates and increased fuel costs. I believe Mr. English stated that investor-owned utilities retained \$3.6 billion in 1981, in amounts collected for the payment of Federal income taxes. Now I ask you, isn't that amount of Federal assistance far in excess of any measure of that provided to the REA's?

Mr. HUNTER. All I can do is read a report from the Congressional Research Service which says that the investor-owned utility support was less than that given to the rural electric co-ops. I think that that can be analyzed in many, many ways, but I think there is a legitimate difference of opinion here.

Mr. TALLON. My time is up.

Mr. JONES of Tennessee. I am sorry. The gentleman's time has expired, and we have a vote on the floor of the House. I am going to yield to Mr. Bedell for a question.

Mr. BEDELL. I will just take a few seconds. The first question I would ask, Will you furnish us with the additional costs that you

used in your formula that are not included in the bill, as per the question by Mr. Stenholm?

If you can answer that yes, we would like to have you do it. We are short on time.

Mr. NAYLOR. Your statement isn't quite accurate. I think we need to be clear that we followed exactly the conditions in the bill.

Mr. BEDELL. We want to know the extra cost in addition to interest that you think should be included in the formula if you are going to have the account balanced. Is that clear?

Mr. NAYLOR. Yes, sir. We can provide that.

[The material follows:]

JAN 20 1964

Inquiry From Congressman Bedell: H.R. 3050 Section 6 Interest Rate Formula

The Bill provides that the standard rate shall be that rate which would produce, from loans approved during a given period, interest income equal to the amount of anticipated interest expense on the RETRF's obligations "required to be issued or sold during such period to cover advances and interest expense: Provided, That the amount of such obligations to be issued or sold for such purposes shall be determined by deducting the sum of principal and interest receipts from the sum of loan advances and interest expenses on outstanding obligations of the account during such period."

We assume that the intent of the Bill is to establish a fund which will not require future subsidies (e.g. a fund in which assets will at all times at least equal liabilities and all obligations will be met in a timely manner). In considering why the formula does not work, it may be useful to note that the borrowing activities of the RETRF do not mirror the lending activities because:

- (1) REA makes loans which have a 35 year maturity with level debt service while REA borrows funds under notes (CBOs) which have a 30 year maturity with no amortization of principal;
- (2) Consequently, during a given period, there is no correlation between either interest payments or the maturity of principal on REA loans and on CBO sales (i.e. since REA loans provide for amortization of principal while CBOs do not, REA may receive principal repayments from loans without having to make a corresponding principal payment on CBOs), and total interest payments on a given CBO are higher over the life of the CBO than the total interest receipts of the loans corresponding to that CBO;
- (3) REA therefore may make advances on new loans from either the a) sale of CBOs or b) those interest and principal receipts of the RETRF which remain after interest payments on outstanding CBO's or c) from a combination of CBO's and receipts.

The standard rate formula is based on the interest expense on CBOs sold during a given period to fund advances after deducting receipts. The formula anticipates that advances will be funded from CBO's and from receipts. However, the formula is calculated solely on the basis of interest expense on the CBOs issued during the given period. No interest is imputed to advances made from receipts. Thus, the net receipts component of the advances is advanced free of interest to borrowers thereby reducing the interest on loans to borrowers at the same time expenses (principal and interest) associated with outstanding CBOs will continue to accrue. To make these payments, it will be necessary for the RETRF to borrow additional amounts in the future through the sale of CBOs. This depletes the assets of the RETRF. Thus, the standard rate formula results in a low interest rate which will cause the continued depletion of the RETRF and its ultimate insolvency.

It may not be a simple matter to correct the problem. The problem can be viewed as a failure to impute interest on advances made from receipts. But what interest should be imputed? That question can only be answered by clearly defining the long term objective of the RETRF. Possible objectives to be considered include:

- (1) to establish a debt free RETRF at some date in the future (this builds the equity of the fund but raises questions as to how quickly interest rates should be increased to meet that goal: it also requires a limited lending program);
- (2) to assure that assets are sufficient to meet liabilities (this eliminates the existing equity of the fund but raises questions as to how fast that equity should be eliminated, i.e. how quickly should rates be increased); and
- (3) to maintain current equity (this might be accomplished by simply adopting the Treasury cost of money rate).

While theoretically it is possible to construct a formula to achieve the selected objective, most such formulas contain inherent problems with definitions and interpretations as well as the possibilities for error. Therefore, perhaps it is better to simply select an interest rate which is tied to the Treasury rate and which will achieve the long term objective. It is important to note that an interest rate which is tied to Treasury may nonetheless provide for a gradual increase to lessen the immediate impact (i.e. Treasury less 6% through 1986, Treasury less 4% through 1988, etc). It should also be noted that the lending level may play a key role in the condition of the RETRF and therefore it may be necessary to consider establishing a statutory annual lending limit.

Mr. BEDELL. OK. That is what we want, I think. We are short on time, but that is what we would like to have. You said that this does not cover all the costs. We would like to have you furnish us a list of the costs that are not included in the formula, according to your interpretation of the formula.

Mr. HUNTER. Congressman Bedell, your question is well taken. We will have that. Incidentally, any other of the details we will be glad to share. We have the computer runs and everything.

Mr. BEDELL. Two other things: You can understand why some of us aren't comfortable leaving it to those who may be here in 1993. We think some of us may not be here at that time, and our wisdom we think is much greater. [Laughter.]

Finally, I hope you are not operating under the misconception that tax-exempt bonds for pollution control equipment are not available to big utilities. Let me tell you, this administration is making it available to all of big business, but no small business can possibly get such a bond. I have brought that up time and time again, and everybody in the world should know that the Reagan administration is saying to small businesses, "We are going to give pollution control exempt bonds to all big business, but small business under no circumstances can get them." I hope everybody realizes that that is exactly what is happening under the policies of this administration.

My time is up. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Bedell.

Mr. HUNTER. Mr. Chairman, could I have just one moment to respond to that.

Mr. JONES of Tennessee. Just one.

Mr. HUNTER. OK, sir. [Laughter.]

I wanted to make the comment that one of the biggest costs involved in the determination of rates is the cost of wholesale power. The wholesale power in REA and the rural electric co-op business relates to the G&T's, and to the generation and cost of that power.

Our borrowers, REA borrowers, have profited to the tune of over \$1 billion this year—just this year—in the sale of tax benefits to others who can use them, so they too have participated. That participation has filtered down and has affected the cost of wholesale power sold to the distribution co-ops.

Mr. BEDELL. We have to go, but just so you don't mislead people, those same tax-exempt pollution control bonds are available to all of big business. Don't think any differently. If you think differently, come to my office and I will show you how you are wrong.

Mr. JONES of Tennessee. Thank you, Mr. Bedell.

Well, gentlemen, I am sorry we have run out of time. I wish we had time for Mr. Gunderson and myself to ask some questions, because I had wanted to. However, time is of essence. We must go vote, and I don't want to hold you here until we get back. Therefore, I am going to take the privilege, also, of writing if there is anything that I want to talk to you about, Mr. Administrator.

The subcommittee will stand in recess until 2 o'clock this afternoon.

[Whereupon, at 12:10 p.m., the subcommittee recessed, to reconvene at 2 p.m., the same day.]

AFTERNOON SESSION

Mr. JONES of Tennessee. The subcommittee will resume its sitting.

We are delighted to have the witnesses that are scheduled this afternoon. I think it is a good idea to start on time. We stopped at 12 o'clock and it is important, I think, that we begin on time in order to finish this afternoon. No doubt we will have some interference with some votes and we will lose some time that way.

Our first witness is already here and we are delighted that he is here: a Member of Congress, our good friend, the Honorable Tom Bevill from the State of Alabama. Tom is a friend of agriculture, a friend of REA, a friend of electricity, rural telephones; and you just name it, and he is our friend.

Tom, we are delighted to have you. You may take whatever time is necessary.

STATEMENT OF HON. TOM BEVILL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ALABAMA

Mr. BEVILL. Thank you, Mr. Chairman. I am pleased to have the opportunity to appear before this distinguished committee, certainly one of the most important committees in the Congress, particularly now during the trying time that our farmers are facing throughout the Nation.

It is rather interesting that this bill that the distinguished chairman has authored—as he points out, of course, with much help of the committee—this bill, in my judgment, is just an example of the good legislation that this committee puts forth and that this coun-

try needs. I believe it was just about 1930 when we had the REA Act passed. My good friend and former colleague from Alabama, Senator Lister Hill, was instrumental in getting this legislation passed in about 1930, as I recall. This country then was just recovering from the Great Depression. The records show that it was very difficult to get any legislation of this type passed. We had the TVA, the REA, and those programs that have meant so much to this Nation and particularly to the rural areas.

Now to some extent we are certainly not in a Great Depression again but we are certainly in a very deep recession. I think any of our farmers in our Nation would say they, the farmers in this Nation, are really in a depression right now. Any help that we can give them, certainly there is no question that it is needed out there.

I know I was just talking to the Farmers Home Administration man who handles the loans for Alabama there not long ago, and out of the 8,000 loans they have made to the farmers there, 7,000 of them are delinquent. He points out that this is typical throughout the Nation, so that tells us something. When we see our farmers in the bind that they are in, of course they can stand 1 or 2 years but when you get up to 4 years, there is no business or no farm or no institution that can stand those kind of losses.

Therefore, our farmers must have help and our rural areas must have help, and certainly the REA has been a big factor in the development of the rural areas of America. We must keep this Fund solvent; we must not permit it to become insolvent because it means so much. This legislation in my judgment is the key to solving this problem.

If we sit back and do nothing, as some will advocate, we are going to have electrical bills in the rural areas running up \$100 a month; it will add \$100 a month because REA is going to have to go out and borrow the money from private institutions at high rates of interest. The result is going to be that it is going to set back and stop the growth and development of our rural areas. The rural areas are going to become stagnant because they are not going to be able to move. They cannot stand that type of charges.

This act has done so much. I mentioned when it was passed there that my friend Lister Hill from Alabama played a leading role in it. He is nearly 90 now but he still talks about the REA, and he still talks about the TVA and those programs, that he was here serving in the Congress when they were passed.

Therefore, I think the record speaks for itself. We have a good program. We have one that we know will work. It has worked for over 50 years, and I think it behooves us in the Congress to see that it stays sound. This legislation, in my judgment, will do that. Therefore, Mr. Chairman, I am delighted to support you in this subcommittee on this legislation because I feel like it is very important to our Nation and very important to the development of our rural areas in this country. Thank you for permitting me to come here and testify before you.

[The prepared statement of Mr. Bevill appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Tom. We can always depend upon you. I knew that you would be favorably re-

ceived and that whatever you had to say would be favorably accepted as far as the legislation is concerned. You have always meant a lot to this committee and this subcommittee. We do appreciate your support and your help in every way.

We will be calling upon you. We are not going to ask you any questions. We chose at the beginning not to ask the Members of Congress questions. If we have a need for questioning we are going to do it by letter, and expect to correspond with you in that manner.

Mr. BEVILL. Thank you very much.

Mr. JONES of Tennessee. Thank you very much. Your statement will be made a part of the record, without objection.

Mr. BEVILL. Thank you.

Mr. JONES of Tennessee. Thank you, Tom.

The next witness is another Member of Congress, and I don't see him in the audience yet. Is Billy Tauzin here, from Louisiana?

[No response.]

Mr. JONES of Tennessee. OK. Let some of the staff here know when he arrives. We will pass him over and then go back to him when he arrives.

The next witness is Mr. Lee Hogan, treasurer of the Power and Communications Contractors Association here in Washington, D.C.

Mr. Hogan, welcome. We are delighted that you have taken time to be with us. You may bring whomever you have with you to the witness table and make whatever introductions you like. I see a familiar face with you there this afternoon, and we are delighted that he is with you.

STATEMENT OF LEE W. HOGAN, MEMBER, BOARD OF DIRECTORS AND CHAIRMAN, LEGISLATIVE COMMITTEE, POWER AND COMMUNICATION CONTRACTORS ASSOCIATION, ACCOMPANIED BY MIKE STROTHER, EXECUTIVE SECRETARY

Mr. HOGAN. Thank you, Mr. Chairman.

I do indeed have Mike Strother, the executive secretary of the Power and Communication Contractors Association, with me. He will be glad to assist if the committee has any questions.

My name is Lee Hogan. I am president of Universal Electric Construction Co. from Houston, Tex. I come today representing the Power and Communication Contractors Association, which is a highly specialized organization in the overall construction industry. However, we do represent 268 corporate members employing 25,000 American workers and completing last year \$925 million of construction work in this country. However, most important to this committee, I think, is the fact that for the last two decades our association members have completed more than 75 percent of the work done by the REA's and RTA's in this Nation.

We want to make it clear at the onset that we do have a direct financial involvement in the REA program and, therefore, our testimony is prejudiced to that degree. However, we feel that our experience with the REA program since its inception in 1936 gives us a perspective that we can beneficially share with the committee in your consideration of H.R. 3050.

This legislation and its Senate companion represent the second opportunity which Congress has had in the last decade to dramatically restructure the REA program—the first resulting in the establishment of the Revolving Fund in 1973. As we see the situation, Mr. Chairman, you have basically three choices: You can employ a phased-in abandonment of the REA program, requiring the REA members through the REA Administration to begin repaying the roughly \$8 billion from 1993 through 2016; second, you can effectively dissolve the Revolving Fund, reverting to the previous system whereby the REA requirements were funded through annual budget appropriations by the Congress; or, No. 3, you can adopt the modifications embodied in H.R. 3050 as recommended by both NRECA and NTCA.

Now there are clearly variations and permutations to those three options, but I think they correctly identify the three philosophies that you must choose between. Our organization strongly supports option three, H.R. 3050, for three reasons: No. 1, we feel that the retention of the REA Revolving Fund, with the interest rates adjusted to match interest revenues with interest costs, will provide a permanent method of sustaining the REA program without an increase to either budget deficits or an upward exertion on interest rates.

No. 2, in today's economy and environment, environmental, engineering, and right-of-way considerations mean that the vast majority of telephone and electric projects require 2 to 4 years from inception to completion. We don't think a program with that time-frame is appropriately matched with a budgeting process that is dependent on year-to-year budget allocations from Congress that may vary wildly with changes in the economic and political climate.

No. 3, and most importantly, however—the standardization of engineering and legal requirements which the REA program has brought to this industry has resulted in directly lower construction costs to the REA's and their members across the Nation. Our association works for investor-owned utilities, municipal utilities, and a variety of other Government utilities such as the Defense Department, the Corps of Engineers, and a variety of power authorities. We have recently completed studies that show our bids to REA customers average 5 to 12 percent below bids to the other utilities for similar projects. This is a direct result of the superior standardization that REA has brought to this program, and those lower costs translate directly into lower rates for REA members.

Mr. Chairman, our association has noted with some concern the criticism that has recently been directed to REA by the USDA Inspector General's Office, as reported in the September 1, 1983 issue of the Wall Street Journal. Although we disagree with the entirety of this report, we feel we have particular expertise in regard to recommendation No. 5 of that report, found in section 2, page 4.

The Inspector General recommends that only those construction projects which were approved in work plans submitted 2 years prior to the need should be eligible for reimbursement through REA Revolving Fund loans. That suggestion, in our opinion, demonstrates such an appalling ignorance of the operation of a utility that it completely destroys the credibility of the entire report. It completely ignores the inevitable consequences of natural disasters,

mineral discoveries, rapidly conceived industrial loads, and changing growth patterns that, Mr. Chairman, simply will not wait the 6 to 8 months that it requires to get approval to modified work plans. Fortunately, the men and women of the REA program and member co-ops have exercised better judgment in providing rural utility service to this country for the past 50 years than the Inspector General did in preparing his report.

In summary, H.R. 3050 provides you with the opportunity to continue one of the most successful and efficient Federal programs to exist for the past 50 years, at no cost to the Federal budget, by adopting modifications to the current system which the electric and telephone utilities have thoughtfully proposed prior to the arrival of a crisis. We sincerely hope that you will share our support of this desirable legislation.

[The prepared statement of Mr. Hogan appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Hogan.

Can you remain around for a short time and be questioned later?

Mr. HOGAN. I certainly can, Mr. Chairman.

Mr. JONES of Tennessee. OK. We would like to get a group to be questioned at the same time, for the sake of time.

Mr. HOGAN. I would be glad to, sir.

Mr. JONES of Tennessee. Thank you very much. We appreciate your being here. Thank you for a good statement.

Did Mr. Tauzin arrive yet?

[No response.]

Mr. JONES of Tennessee. If not, the next witnesses are a group: Mr. David Fullarton, the executive vice president, and Mr. Joe Vellone, special counsel for the National Telephone Cooperative Association here in Washington. Dave, you may have other members also with you that you would like to bring to the witness table.

STATEMENT OF DAVID C. FULLARTON, EXECUTIVE VICE PRESIDENT, NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

Mr. FULLARTON. Thank you for the privilege, Mr. Chairman. We have not only members of our staff but our Government Affairs Committee and our national president here. I won't introduce them. It is quite a long list, but on their behalf I would initially like to express our joint appreciation for the fact that H.R. 3050 is before you, and the consideration being given to it.

Mr. JONES of Tennessee. Well, we are delighted that you are here and we are glad you could take the time. I just want to mention the fact that I do see your general counsel from the great State of Tennessee is here, Jim Bass.

Mr. FULLARTON. The great State of Tennessee, Mr. Chairman.

For the record, Mr. Chairman, my name is David C. Fullarton. I am the executive vice president of the National Telephone Cooperative Association. With me today is Mr. Joseph Vellone, special counsel on the NTCA staff. I would like to introduce him further at the conclusion of my brief remarks.

We are most appreciative of the opportunity to appear before this subcommittee to express our views on legislation, H.R. 3050, the self-sufficiency act for REA. NTCA is the national organization

representing rural telephone systems in 42 States. We have about 430 corporate members. We have been appearing before this subcommittee and committees with similar interests to it for many, many years, and we appear here today in unqualified support of H.R. 3050.

I would request at this point that my prepared statement be made a part of the record, and that I be allowed to address what we feel are its more salient points.

Mr. JONES of Tennessee. Without objection, the entire statement will become part of the record, and you may summarize in any way you like.

Mr. FULLARTON. Thank you, Mr. Chairman.

The subject of my presentation this afternoon is the subject of change. We believe that this legislation in its very heart addresses that subject of change. The REA programs have undergone significant change over the years with the help of this subcommittee and the full House Agriculture Committee. After 7 years of effort on the part of the Members of Congress and interested groups, for instance, the Rural Telephone Bank became law in 1971, bringing to the borrowers and to rural telephony, in the first instance higher interest rates but in the second instance a broader capital base for continuing improvements.

A previous witness mentioned the Revolving Fund legislation in 1973. That, of course, followed a significant impoundment by the then administration of existing REA loan funds. That Revolving Fund is the subject of H.R. 3050, to the extent that the 1973 legislation set up as the assets of that fund the outstanding notes of REA borrowers, and as liabilities some \$7.9 billion in notes from REA to the Treasury, which is the specific subject of this legislation.

The sources of funds for that Revolving Fund were, of course, the collections of interest and principal from the borrowers; interim borrowings from the Treasury which became necessary from time to time; and through the issuance of certificates of beneficial ownership. There has been significant change in the REA programs to match the changing needs of the borrowers and the changing environments within which they were providing service.

We are, of course, very much interested in the telephone program, although we are supporting all elements of this legislation, and our interest in the rural electric program matches our overall interest in rural development. The telephone industry has changed significantly over the years as well.

The two basic reasons for this change are, in the first instance, technology. Where we were using hard-wired circuits in talking to our neighbors, essentially years and years ago, we are now in the age of computers, satellites, all those kinds of things which come about and bring both better service to rural America and a better communications network to the world.

More recently, the telephone industry is also faced with the advent of competition in deregulation. This has various impacts on the operations of rural telephone systems, and it is not unrelated to the needs of the REA program, either. Essentially, the advent of competition in the telephone industry presents some very hard facts for rural telephone systems to face.

Not being involved in the more dynamic long-distance business, we are there in rural areas attempting to serve our subscribers at reasonable costs and with, of course, first-class service. In order to be able to do that, rural telephone systems are going to have to diversify, diversify their services which are in the realm of telecommunications, diversify their services in other areas as well, all in order to keep rural telephone costs within limits that are reasonable and with costs that will allow the continued availability of service, universal telephone service, to everybody who wants it.

In the third case, there are some things that don't seem to change much at all. Rural telephone systems continue to serve the most sparsely populated areas of the country, low density, and with the incidental high costs. We are faced still with the continued general unavailability of commercial financing for our activities by virtue of low debt equity ratios.

The other thing that has not changed is, I do not believe this great Nation has outlived the need for a national policy of universal telephone service, that is, service at reasonable costs to all who wish it.

We are looking to the future as we think this legislation looks to the future, and we are asking the help of this committee and of the Congress to get there. The heart of the legislation, as I mentioned earlier, is change to meet future conditions and future needs. Diversity is essential, and this legislation is needed if we are to be able to diversify to the extent required. The real need of the REA programs is to be viable in tomorrow's environment, and to be viable the programs need this legislation.

There are two major problems with REA itself: Current policy makes it generally impossible to go to private lenders for new services—the lien accommodation problem, as it is referred to in the legislation. Second, current REA policy restricts borrowers' abilities to utilize their own funds to diversify. This is referred to as the general funds problem. We have been to the administration over and over again seeking solutions and relief to these two problems, but to no avail, and it is my understanding the REA Administrator's testimony this morning revealed that REA is looking at the past, not the future.

Another problem, of course, is the imbalance in the Revolving Fund where potentially, at least, a huge Government bailout will be required in the years ahead if this is not corrected.

The proposed legislation addresses all three areas, we think, in a satisfactory manner. However, rather than play the expert, I would like to introduce a gentleman who is truly qualified to speak in the areas of REA administration and operations that this bill addresses.

Joe Vellone came to our staff in early 1982 as special counsel. He was previously the Acting Assistant Administrator for Administration for REA. I would like to say that Joe spent 50 years at REA; he assures me it is not quite that long. He was Assistant Secretary of the Rural Telephone Bank. He has provided technical assistance to this subcommittee and the full Agriculture Committee on numerous occasions, including being involved in the creation of the Revolving Fund in 1973 as a Government adviser.

We are happy he is on our staff and, as I said, I don't know of anyone that is better qualified to address the technical provisions of this bill. With that, I would like to ask your permission to turn the chair over to Mr. Vellone.

[The prepared statement of Mr. Fullarton appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you, Dave.

Joe, we welcome you to this hearing and we are delighted to hear from you at this point.

**STATEMENT OF JOSEPH VELLONE, SPECIAL COUNSEL,
NATIONAL TELEPHONE COOPERATIVE ASSOCIATION**

Mr. VELLONE. I want to thank you for the opportunity to be here to testify in behalf of legislation that is so necessary to make the Rural Electrification Act more responsive to the needs of rural America.

The association's executive vice president has presented, in his remarks and prepared statement, the need for the legislation in the changing environment. As a technician, I would like to prepare for the record a description of the various amendments in the act and give you the reasons why we believe these amendments do deserve your support.

At this point, since it is a lengthy technical statement, prepared mainly for the record and for the help of your committee and its staff, I would ask that the entire statement be put in the record, while I highlight just a few of the more important provisions and then stand ready to answer questions.

Mr. JONES of Tennessee. Without objection, that will be included in the record.

Mr. VELLONE. The amendments fall in four general groups. There are a group of amendments that amend the telephone loan program part of the act. The second group of amendments are the general amendments that cover both the electric and telephone program. The third group of amendments consists of only one, and it applies only to the electric program. The fourth group of amendments will amend certain provisions dealing with the activities of the Rural Telephone Bank.

The first of the amendments talks about eliminating a nonduplication finding for REA telephone loans. The reason for recommending this is that without correcting this situation, it is going to be very difficult for rural telephone systems to live in this changing, competitive environment.

In most of the States of this Union there are commissions which issue certificates of convenience and necessity to telephone systems so that they can proceed with the construction they have in mind. In those cases, REA does not concern itself with whether or not the proposed construction will duplicate existing facilities, but in some 15 States—as listed at the top of page 2 in my prepared statement—you find that there is no commission that issues a certificate of convenience and necessity for the REA telephone borrowers.

In those States, the REA Administrator is required to make a finding that the proposed construction will not result in the duplication of facilities rendering reasonably adequate telephone serv-

ice. The problem there, of course, is that this gets involved in many legalisms, and as a result thereof we see problems ahead when these rural telephone systems find it necessary to have a new connection, perhaps, with another interstate carrier such as MCI.

Now it is possible that the REA Administrator would say, "That is not necessary, and it would duplicate existing facilities. You already have a connection to the outside world through the Bell System." Yet we had testimony at our field conference recently, our fall conference in Denver, to the effect that the provision of such links to outside carriers can add immeasurably, in fact, double the revenue from the new connection, over not having the new connection. Therefore, we think it is very important to eliminate that required nonduplication finding.

This does not in any way lessen the requirement for these telephone systems to comply with the requirements of State commissions. There is another section in the act that covers it fully which says, in essence, that no loan will be made that doesn't comply with the requirements of the State commission.

We also want to revise the definition of telephone service, mainly to clarify the present definition and to recognize the new technologies that are in effect now, and actually in use by most telephone systems to make the connections and the transmission of telephone service. We want to specifically include data and transmission by wire, fiber, radio, light, or other visual or electronic means. Now that is being done today, but the definition itself is a little behind the times and we think it is time to come into the present decade.

The big issue, as you probably heard this morning, has to do with increasing the Revolving Fund's equity capital. Section 401 of the bill provides that "Notes of the Administrator to the Secretary of the Treasury to obtain funds for loans under sections 4, 5, and 201 of this Act shall be equity capital of the Fund instead of liabilities of the Fund." I was pleased to see a number of witnesses today point out that the U.S. Government is the owner of the Fund, and all this means is a change in the form of its ownership, from providing debt capital to providing equity capital. This amendment will strengthen the Revolving Fund. It will reduce the need for new borrowings or sales of certificates of beneficial ownership to keep the fund viable.

To understand the operation of the Revolving Fund, it is necessary to review the Fund's origin. Now as Mr. Fullarton indicated, the Revolving Fund came into being after an effort to impound the program's funds at the end of 1972. That is when the effort was made to transfer the rural telephone and electric programs to a new funding mechanism, but it was this committee that made it clear that the Rural Development Act was not designed for the purpose and was never intended by the Congress to be used in such a fashion.

As a result of that, after much effort on the part of the rural electric and telephone systems, this committee did enact legislation that established the Revolving Fund on May 11, 1973. The Fund was established by the transfer to it of a number of existing assets as well as existing liabilities of the Fund. A few years after 1973 two more notes were issued which also became liabilities of the Fund. I would like to record them for the record because they re-

flect the fact that Government agencies can make mistakes that are corrected by the courts and the Congress. Those two notes involved a settlement on the *Sioux Valley* case and the unimpoundment of the appropriations that were impounded in 1972.

All collections of principal and interest on the loans made to REA are assets of the Fund and are used to make new loans. These collections, supplemented by the undisbursed balance of notes to the Treasury, were sufficient to cover advances to the borrowers through fiscal year 1975. That was the first year we started selling certificates of beneficial ownership, or CBO's, to get the funds to keep the program going.

Now I think we may have gotten a mistaken impression of the activities of the Revolving Fund and the purpose of the Revolving Fund and what a revolving fund is, in some of this morning's testimony. A revolving fund is one that revolves collections but also has authority, in every case, to borrow money and obtain money from other sources. There is nothing in a revolving fund that makes it impossible to borrow money from other sources, and yet that was one of the main themes of the administration's testimony this morning.

Also overlooked in the testimony this morning is the fact that the 1973 amendments, like provisions for all other revolving funds, do provide for the appropriation of funds required to cover interest subsidies and losses. That was not mentioned at all, in fact, overlooked entirely. In fact, overlooked entirely was the fact that this year, for the first time in the history of this particular Revolving Fund, an appropriation was passed by both the House and the Senate to cover interest subsidies and losses.

In the report on the appropriation bill it was made quite clear—and I am quoting from the report at the bottom of page 4 of my testimony—

This appropriation is to reimburse the Rural Electrification and Telephone Revolving Fund for the differential between interest income and interest costs. The amount recommended by the Committee represents interest costs less the imputed interest associated with loans transferred * * *.

The Committee feels that the Rural Electrification and Telephone Revolving Fund should be treated the same as the other revolving funds of USDA. Unlike the other revolving funds, there has never been an appropriation to this Fund. In Fiscal Year 1984 the appropriation for interest and other losses of the other funds are as follows:

The first one listed is the Rural Housing Insurance Fund. The appropriation for interest subsidies for that one fund alone for 1 year was \$1,508 million; for the Agricultural Credit Insurance Fund, \$895 million; and for the Rural Development Insurance Fund, \$478 million.

As the committee report indicates, "Rather than allowing the Fund to continue to deplete its assets, the Committee recommends an appropriation of \$198 million to restore the Fund to a sound financial basis."

Now the administration was completely silent on the fact that existing law does authorize appropriations for interest subsidies and losses. The purpose of this history is to make it clear that if there is no action taken to amend the law at this time, to balance the Revolving Fund by authorizing periodic adjustments of interest rates as recommended herein, the amounts of appropriations

needed for interest subsidies authorized by present law will greatly exceed the amount of non-interest-bearing notes proposed to be exchanged for equity interest in the Fund.

It should be recognized, as was pointed out this morning, that these notes do not become due for another 10 years. Yet, in this legislation the electric and telephone systems are willing to accept higher interest rates today and the next year and the year after, in order to have a better electric and telephone program and to ease the burden that they foresee would happen in the years ahead if no action is taken now. Here is a forward-looking effort on the part of the rural utilities of the United States to do something about a situation where no action has to be taken today, but they do want to make sure that the REA programs are conducted in the best interests of all America, at the least cost to the Federal Treasury, and at the least cost to the consumers of rural America.

One thing that is also overlooked is the fact that the 1973 legislation makes it clear that the Revolving Fund has authority to borrow to meet all of its obligations. Overlooked again in all of the discussions about the \$7.8 billion of notes payable is the fact that the repayment of these notes on schedule will not reduce the national debt one iota, because the only way it can be done is to borrow anew, in other words, roll over the existing indebtedness. Rolling over the existing indebtedness will not reduce the national debt. Instead, it will increase the cost to the rural consumers of America for electric and telephone service.

Another item that we would like to talk about briefly is separating the electric and telephone accounts within the Fund. This is a proposal that has been recommended by the membership of both associations. Each of them is concerned that the collections that they put into the Fund are used for their own programs. They have seen what has happened in the past. Not too long ago the administration recommended a zero loan level for the telephone program. You can imagine how disturbed the rural telephone systems were to find out that not only were they to be cut off from REA loans, but that their own collections would be used to fund another program.

There has been some discussion this morning about the proposal to authorize the repurchase of CBO's without penalty. CBO's have been issued by the Federal Financing Bank. One thing that should be made clear is that the Federal Financing Bank has been borrowing short term to obtain the cash for these long-term obligations. Therefore, it has made a profit on these loans in more ways than one.

Its formula for determining the cash needed to repay a CBO generally results in a penalty which discourages such prepayments. The ability to make these prepayments could result in substantial savings in interest costs for the Revolving Fund and the rural people served by its borrowers, without any real cost to the Federal Financing Bank which has only borrowed on a short-term basis to meet these requirements.

There are other technical amendments in here that I will pass over until we get to the one on lien accommodation authority. This has been something that both the electric and the telephone programs have been struggling with for a number of years. It is

almost impossible for rural telephone systems to obtain money elsewhere. There is much lip service to the principle of encouraging borrowers to get some of their financing from other sources, but there has been no effort to facilitate that.

REA has a number of purposes which it will not provide money for, including many that are covered by the act but it does not make it easy, with the "after acquired" clause in its mortgages, for other lenders to make the loans that these telephone systems would like to have to finance the many activities that could be financed and produce additional revenues to offset the expected decline in revenues from plain old telephone service.

One minor point that we would like to make at this point which is of consequence to the borrowers from the Telephone Bank, is the limitation on acquisitions with Telephone Bank loans. They cannot be larger, if they are exchange facilities, than the size of the telephone system when it got its first loan from the Telephone Bank, and that could be more than 10 years ago. This restriction will unduly prevent necessary consolidations of territories to realize operating economies.

Surprisingly enough, there is no limitation on the size of acquisitions which apply to the lower interest rate loans available from the Revolving Fund, only to the higher cost Rural Telephone Bank loans. There is also a recommendation that the interest coverage requirement for telephone bank loans be made more flexible so that more optimum use could be made of the funds available from both sources for telephone systems. The other things in the Telephone Bank part of the bill have to do with providing the same sort of changes that are also being recommended in the basic telephone program.

I want to point to exhibit 1 at the end of my testimony. That is a very interesting statement which emphasizes how the administration is not looking at the full picture. Here is a simple chart that has been distributed widely by REA, and it does show the gross notes receivable; that is the sold line. Those are the notes received from the borrowers for loans made. The line that goes to the zero point about 1999 or thereabouts is the net balance of unsold notes, that is, the assets that REA would have to pledge against further borrowings.

Now this chart was based on the assumption that there would be no appropriations for interest subsidies and losses until the matter could be delayed no longer, and around 1999 or thereabouts, that is when it happens. In the period between 1993 and 2016—and those are the calendar years—under REA's own figures, if nothing is done today to keep the Revolving Fund going, it would require appropriations for interest subsidies amounting to \$30 billion, almost four times the amount of notes that has been the major part of this morning's testimony.

Therefore, I believe it is important to realize that the rural electric and telephone systems of America are looking forward to obtaining, from the administration and through this legislation, more viable programs for the electric and telephone systems in return for a higher interest rate today. It is all part of a package and should be considered as such.

We are very thankful for the opportunity to be here today to present this testimony, and will stand ready to answer questions on other technical matters.

[The prepared statement of Mr. Vellone appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Joe and Dave. If you will step aside, we will call you back after we have heard the other witnesses, then.

Mr. FULLARTON. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. I appreciate it very much.

Now we will go back to the beginning of the testimony and call Congressman Billy Tauzin of the State of Louisiana to the witness table for his testimony.

Billy, we called for you earlier and we are glad that you are here now.

Mr. TAUZIN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. I see Congressman Stangeland has come, too. Arlan, I guess you want to make your testimony today rather than tomorrow, too. Right?

Billy, you may proceed.

STATEMENT OF HON. W. J. (BILLY) TAUZIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF LOUISIANA

Mr. TAUZIN. Thank you, Mr. Chairman.

My apologies, first. We were debating a broadcast deregulation issue on the other side.

I am from a little place in Louisiana called Chackbay, and I married a girl from Choupic, which is kind of a suburb of Chackbay, I guess. You won't read about them in Newsweek or Time magazine. They are not populated areas of the country, but they are a great place to be born and raised in, I assure you, and they are typical of rural America.

In south Louisiana, in the bayou country, there are lots of little places like Chackbay and Choupic. Lots of them only recently got electrical service. Many people who live in south Louisiana still do not have electrical service. Louisiana has about 1 million customers on the rural electric cooperative program, 1 million in a nation that has 250 million, so you can see we are quite dependent in our State upon this important program.

In many south Louisiana bayou country areas there are marshes and swamps, and areas where people live almost year 'round trapping and hunting and fishing. Many of those places still do not have electrical service. In Louisiana, as in the rest of the Nation, our Government helps subsidize public television to bring culture and arts to communities that might not otherwise receive arts and culture, and we subsidize beautiful programs like "Sesame Street." We are doing our best as a nation to make sure every child has the opportunity to receive some form of educational television. We are about to debate in the Congress a bill to make sure that universal telephone service is maintained, when it might be threatened with rates that are not affordable to all Americans.

Yet, even while we debate whether folks should have a telephone universally and whether kids ought to have educational television

programs, or whether Government ought to continue subsidizing the opera and the other arts and cultural programs, some American citizens who happen to live in the rural parts of our country are still doing without such a basic necessity as electricity. Without electricity, you can imagine those other beautiful options in entertainment and information available to the American public are completely out of reach for those citizens.

Therefore, Mr. Chairman and members of the committee, I come today to urge you and encourage you to support the bill H.R. 3050 because it does, I think, help continue the effort to provide electricity for rural parts of America. Without H.R. 3050, rural electric cooperatives in our State and others are going to be forced, if you will, to try to seek capital from the marketplace rather than their primary source, which has been the Revolving Fund. As you know, the Revolving Fund has provided low-interest capital to construct and maintain electrical service to people who would not otherwise get it.

The cooperatives in Louisiana own one-half of all the electric lines servicing Louisiana, and yet they receive only 6 percent of the State's utility revenues. Our investor-owned utilities are not going to extend electrical service to those communities and those consumers because they are, of course, conscious about rate of return. Without the help and the subsidy provided through this bill to the Revolving Fund, rural Americans and rural Louisianians will not be able to enjoy the possibility of electrical service such as was recently extended to very rural areas of the marshland of Louisiana to 500 residents, through an electric cooperative, just recently.

This addition, this help to the Fund, this ability to allow it to take in—to charge, if you will—higher interest in order to provide interest to electrical companies at lower rates than what the marketplace might require, is absolutely essential. You may have heard testimony that interest rate is not a substantial factor in the generation of electricity. Well, I can tell you that in Louisiana the cost of interest is fully one-third of the cost of building a new electric powerplant in Louisiana. Now that is significant to me, and it is significant to the companies that are looking at the option of whether or not to serve citizens who recently do not have electrical service, or who need that electrical service upgraded and updated. Interest cost and expenses is indeed a very important element to rural electrification.

I might also add, as I am sure you know, that cooperatives are low-equity operations. It is very difficult for them to go into the financial marketplace and borrow, as would a high-equity operation have the opportunity, at rates that they might be able to afford. Therefore, gentlemen, I urge you as you consider H.R. 3050 to support those provisions that continue the financial stability of the Revolving Fund.

Allowing it to beef up its interest income is vitally important if it is going to keep up with interest outflow. Second, giving it the infusion of some Federal help by allowing it to borrow from the Federal Treasury at market rates is, I think, essential if we are going to continue its operation as the basic source of financing for rural electric companies in Louisiana and throughout the Nation. Folks

in Chackbay and in Choupic will applaud you, if you make sure that Revolving Fund is around when we need it.

I thank you very much, Mr. Chairman.

[The prepared statement of Mr. Tauzin appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Bill. We appreciate your testimony very much. It was very helpful, very good, and very constructive.

Now for my good friend from the State of Minnesota, the Honorable Arlan Stangeland. Arlan is a member of this committee, the full Agriculture Committee. We are glad to have you, Arlan.

**STATEMENT OF HON. ARLAN STANGELAND, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF MINNESOTA**

Mr. STANGELAND. Thank you, Mr. Chairman.

First of all I would like to commend you for introducing H.R. 3050, and for taking the initiative in pursuing a legislative approach that will help keep the Federal Government's rural electric and telephone credit programs operating on a stable, self-sustaining basis. I am proud to be a cosponsor of H.R. 3050, along with 158 other Members of the House. I believe this bill calls for a number of improvements over existing law which would better assist our rural electric and telephone cooperatives in providing affordable and dependable utility service to rural consumers.

The primary problem we are addressing here today involves the fact that REA's revolving loan fund has been losing ground due to high interest rates. While insured loans from the Fund have been pegged by law at 5 percent since 1973, the Revolving Fund has had to pay much higher interest rates in recent years in order to obtain capital from the private market via the Federal Financing Bank.

H.R. 3050 proposes a number of steps to get the Revolving Fund back in balance while maintaining adequate access to REA financing at reasonable rates and terms. For example, H.R. 3050 authorizes the Administrator to set the interest rate on new loans at the level required to restore and maintain the balance in the Revolving Fund. The bill further proposes that \$7.9 billion in notes due the Treasury beginning 1993 would instead be converted into permanent equity capital of the Revolving Fund.

In addition, important safeguards and protections are included in H.R. 3050 pertaining to low-interest hardship loans, supplemental financing ratios required for REA electric loans, and modifications in the legal definition of telephone service to reflect technological breakthroughs over the past 20 years in telephone transmissions. There are numerous other provisions in the bill affecting both the REA electric and telephone programs which address the imbalance in the Revolving Fund while at the same time protecting REA borrowers and their member/customers from excessively high credit costs.

I believe it is absolutely essential that we in Congress take whatever corrective actions are necessary to assure the long-term strength of the Rural Electric and Telephone Revolving Fund and, with it, the future viability of the REA electric and telephone lending programs.

The Rural Electrification Administration is one of the great success stories insofar as Government programs intended to assist rural America are concerned. When REA was first created in 1935, only 10 percent of our Nation's farms had central station electric service. Today electricity is available throughout rural America at rates established by local boards of directors within the guidelines set by Congress and the REA, and I am sure happy that they finally got it down there in Louisiana to my dear colleague, Mr. Tauzin.

In fact, electricity coming to rural America and to rural Minnesota is so recent—and I think I testified to this a year ago—that I can still vividly remember when we first got electricity on our farm back in November 1941. There are some of us here in Congress and on this committee who still remember how we had to use kerosene lanterns before electricity was available on the farm. That all changed for much the better, I might add, with the implementation of the REA program which assisted the rural cooperatives in delivering electricity to the farms and sparsely populated areas of rural America.

I would just like to point out here that I think one of the great reasons for the tremendous success story of agriculture, production agriculture, has been the availability of electricity, and cheap electricity. Without that electricity we couldn't be as productive as we are and as an agricultural community, from rural America, we couldn't provide the food and the fiber at the rates that our consumers are having to pay—the cheapest in the world, the most abundant supply of the highest quality food. Certainly electricity has played a major role in that tremendous success story.

However, we must not now turn our backs on existing rural electric and telephone cooperatives as if the job were finished. Electric rates paid by consumers in rural areas are on the average 12-percent higher than those paid by urban consumers in the more densely populated areas. This is primarily due to the fact that rural distribution lines average only 4.6 consumers per mile while, in comparison, commercial utilities average 35.8 consumers.

Furthermore, I know I don't have to persuade the members of this committee about the uncertainty that telephone deregulation imposes upon our rural telephone co-ops and their member/customers. Current projections of skyrocketing rural telephone bills under deregulation surely pose a serious threat to the goal of universal service, and would result in a communications catastrophe that our rural constituents in this country cannot afford. Needless to say, now is certainly not the time we should be thinking of scaling back traditional REA support for our rural electric and telephone cooperatives.

Ever since REA was first established, it has been the principal source of capital for rural utilities. Without the Federal support that REA provides our rural co-ops, it is questionable whether or not they could attract the private investment needed to continue operating in areas of rough terrain and low-population density. Even if financing could be found, the loans would certainly carry a higher interest rate than these rural cooperatives can now obtain. That is why it is particularly important that we maintain our strong commitment to the REA program and assure our co-ops that

they will not be forced to depend on private credit for an undue portion of their financing needs.

While H.R. 3050 may not be the final word in terms of whatever corrective legislation we ultimately pass to restore the balance and stability of the Rural Electrification and Telephone Revolving Fund, this bill contains a number of important safeguards and improvements over existing law that would help moderate our rural constituents' utility bills. For example, a rural electric co-op that serves a number of my constituents has advised me that the provision in H.R. 3050 which authorizes lenders to periodically refinance REA-loan guarantees without penalty would alone save the average rural family they serve about \$50 per year.

Providing dependable, affordable utility service to rural America is no easy job, and I for one want to commend our rural cooperatives for the tremendous job they have done. These locally owned and nonprofit co-ops have not only provided reliable electric and telephone service to rural America, but have also led in the development of rural services and helped bring thousands of new jobs to our rural communities.

During the coming years of economic uncertainty, it is especially important that we assure those co-ops of continued access to REA financing. We must now take the bold steps necessary to put this present funding crisis behind us and guarantee a strong, self-sustaining REA program in the future that will meet the electric and telephone needs of our rural citizens for generations to come.

Mr. JONES of Tennessee. Thank you very much, Arlan, for a very fine statement.

We are not asking the Members of Congress to remain for questioning. If we need to contact you, we will do so by letter, but we do appreciate your taking the time out to come over.

Mr. STANGELAND. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thanks a lot.

The next witnesses are a group: Mr. A. Harold Peterson, the executive director and counsel to the National REA Telephone Association here in Washington, accompanied by Mr. Robert S. McClelland of Columbia, Mo., president, and Mr. John F. O'Neal, the associate counsel—familiar faces around here, and we are delighted to see you gentlemen back today. You are welcome to proceed in whatever manner that you like. Whoever takes over first may do so.

STATEMENT OF A. HAROLD PETERSON, EXECUTIVE DIRECTOR AND COUNSEL, NATIONAL REA TELEPHONE ASSOCIATION, ACCOMPANIED BY ROBERT S. McCLELLAND, PRESIDENT, NATIONAL REA TELEPHONE ASSOCIATION, AND JOHN F. O'NEAL, ASSOCIATE COUNSEL

Mr. PETERSON. Thank you very much, Mr. Chairman.

Mr. JONES of Tennessee. I see Mr. Peterson is leading off.

Mr. PETERSON. First of all I want to tell you how much we appreciate the opportunity that has been extended to us to appear before your committee and testify in support of H.R. 3050. With me today is Mr. Robert S. McClelland, who is the president of our National REA Telephone Association. He comes from the State of Missouri.

Also with me today is Mr. John F. O'Neal, our associate counsel, here from Washington, D.C.

Before I go any further, Mr. Chairman, I should like to ask that my statement be put in the record and that I be permitted to comment very briefly about the statement and two or three other points.

Mr. JONES of Tennessee. Without objection, your entire statement will become a part of the record and you may summaries as you please.

Mr. PETERSON. Mr. Chairman, at the outset I want to assure you that the National REA Telephone Association concurs 100 percent in the testimony that you have heard presented by the National Telephone Cooperative Association through its executive vice president, Dave Fullarton, and from Mr. Vellone. They have done a very thorough job in indicating to you our concerns on the telephone side.

This association has been working very closely with the National Telephone Cooperative Association as well as the National Rural Electric Cooperative Association to attain a common goal, and that is to protect the REA program, both electric and telephone. It was Mr. O'Neal's and my pleasure to be in San Diego last January when Mr. Fullarton's organization passed a resolution supporting the trust of what this committee is discussing now. It was also Mr. O'Neal's and my pleasure to be in Las Vegas, Nev., when the National Rural Electric Cooperative Association passed their resolution.

Having said that, it would be highly presumptions on our part to take the time of the committee to go over in detail the points that have been presented by Mr. Fullarton and Mr. Vellone, so I will not indulge the time of this committee to do that. I would, however, like to make two or three comments about our statement.

It is a rather long statement—it is 20 pages long—and purposely so. As we determined what was before this committee, it occurred to me, Mr. Chairman, that you and you alone are the only Member who was present as a member of that subcommittee 10 years ago when the major changes took place in the REA Act. There are only about 33 U.S. Senators and 129 Congressmen today who were here 10 years ago.

Therefore, I thought it was proper and necessary that we recite some of the history of this program so that those younger people might have a clearer understanding about how this program came about and how it can be differentiated from some of the programs that the Federal Government has been involved in over the years, and which have not received the kind of acclaim that this one has. Make no mistake about it, Mr. Chairman, we are very much convinced that the REA program involves a productive investment. It is not a program wherein the U.S. taxpayer has just thrown money down the drain. It has brought untold benefits to rural America, both socially and economically, and I think everybody understands that.

I am old enough to remember what happened at the time of the passage of the rural telephone amendment in 1949. The fact of life is that at that time there was absolutely no opportunity for these thousands of telephone companies located throughout the United

States to obtain the necessary debt capital to improve and expand, modernize and extend the telephone systems in this country. Fortunately, the Congress of the United States realized that and, having seen the wonderful experience on the electric side, decided that the same could be done for telephone.

I say that not only to indicate that there was a financial vacuum in those days but to also state that in this day and age debt capital is not as available for rural telephone companies as some people would have you believe. When you consider the fact that the net worth of REA telephone finance companies in this country is only 26 percent, you have to understand that that is not the kind of net worth that a New York banker or insurance company is interested in.

To us the REA telephone program, both electric and telephone, is as needed and as vital today as it was in 1949. I think it was appropriate that Congressman Beville came here this afternoon to let the committee know what his support of this program was, because it was in his State of Alabama that the first REA telephone loan was made in 1959 to the Florida Telephone Co.

We have had some problems over the years with our program. Of course, you, Mr. Chairman, having been here 10 years ago, remember what happened on that black Friday of December 29, 1972 when another administration sought to abolish the program, both electric and telephone. Fortunately, the Congress of the United States didn't buy that, and the following May it passed into law major amendments to the REA Act which not only brought the program in better focus but strengthened it. Of course, it was at that time that the Revolving Fund was instituted. I say this so that we can remind ourselves that from time to time the REA program, whether it be electric or telephone, needs to be modified in order to keep up with the times.

In another part of my statement we talk about the changes that are occurring in the telephone industry. Mr. Fullerton gave you a very vivid description of what that amounts to, so I am not going to spend a lot of time on that except to tell you that there are a lot of telephone companies out there today in rural America who frankly are very, very concerned about their future. That is another reason why it is imperative that this committee of Congress stand firm behind the telephone program, in view of the traumatic changes that are taking place.

I noticed that Congressman Skeen was here earlier. I can tell you that in his own State of New Mexico one of our directors, who has testified before this committee on a previous occasion—I believe it was 2 years ago—Mr. Jack Keene, who operates a telephone territory there as large as the State of Maryland, 10,000 square miles, is very, very concerned about his future.

I think I have said enough about the change in the industry. You can all read about it in the papers, and the media is zeroing in on it more and more every day. What is going to happen in the Commerce Committees of this Congress is still uncertain. Come January 1, 1984, there are some very, very traumatic changes that are going to take place under an FCC order, and it appears that there might be a possibility of legislation to change that direction. There

are certain people in this Congress who are very concerned about it, as we are.

The third part of our statement concerns that proposed changes in the bill, and I am not going to mention those because they were very aptly described by Mr. Vellone.

Before closing, I would like to make two other comments. I was rather disappointed this morning when the administration testified, and I regret to say that because I have the highest regard and respect for the REA Administrator. He is a very fine gentleman. However, I have been around this town long enough to understand the constraints which are placed upon any REA Administrator in what they can and cannot do, what they can and cannot say.

I think that when this morning's session was over, there was a cloud. I hope that tomorrow, after you hear the testimony of the National REA Electric Association, that that cloud will be lifted. I do not see why it cannot be. I am sure that it will. I know that there are folks sitting in this room at this very moment who are going to strive to their utmost to be sure that this committee is not misled as to what it can and cannot do under H.R. 3050.

Before closing, Mr. Chairman, I must say one other thing. Next April I am going to be 65 years old, and I have promised my wife that when that day comes I am going to retire from the Washington scene. I say that to this subcommittee now because, as I look back over the 22-some years of having come before various committees in this Congress in support of the REA telephone program, I have many fond memories, as I know you have, in trying to protect this program. I shall miss it but I shall have many fond memories. I want you to know, Mr. Chairman, that I appreciate the work and the effort that you have done over the years to protect this program, which has been so vital to the people of America.

I thank you very much. Mr. Bob McClelland wishes to say a few words.

[The prepared statement of Mr. Peterson appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Harold, for a very challenging statement. I am looking forward to reading the 20 pages of your statement.

Before we go to Mr. McClelland, I want to say that it will be a sad moment that we fail to see you here, because you have been worth a lot to this subcommittee and especially to the telephone industry. You have been a right arm in many respects to the work that we have done here. We appreciate, more than you know, the good work that you have contributed to the legislation that we have passed here from time to time and that we have worked on. We will miss your counsel and your help.

Mr. PETERSON. Thank you.

Mr. JONES of Tennessee. Mr. McClelland.

**STATEMENT OF ROBERT S. McCLELLAND, PRESIDENT, NATIONAL
REA TELEPHONE ASSOCIATION**

Mr. McCLELLAND. Thank you, Mr. Chairman and members of the committee.

My name is Robert McClelland, I am from Columbia, Mo. I appear here as president of the National REA Telephone Association, and I wish to thank the committee for the invitations extended to me to appear here today. I am also well-pleased to see my Congressman, Tom Coleman, present on the subcommittee today.

I have but a few brief comments to make. I am executive vice president of Missouri Telephone Co., which serves approximately 14,500 customers in 17 exchanges located in 9 rural counties in the State of Missouri. These exchanges range in size from our smallest at Allendale, Mo., which serves 133 customers, to our latest at Bolivar, Mo., which serves approximately 3,500 customers.

I am proud to tell you that my affiliation with the REA telephone program goes back 33 years, when I first helped a group of farmers organize the Green Hills Telephone Co. at Breckenridge, Mo., and get started on their first REA loan. The area these farmers came from was totally without any telephone service.

I have been with the Missouri Telephone Co. for 30 years. I know full well what Mr. Peterson was talking about concerning the financial vacuum that existed at the time the REA telephone program came into being. We labored hard and long to get financing with which to rebuild our wornout system, and it was soon obvious to us that the banks and insurance companies we talked to were not interested in us because we were serving areas that nobody else wanted to serve.

Those of us old enough to remember this, if you go back during the Depression days of the 1930's, then followed by World War II, people were used to being deprived of many services and didn't object to minimal quality telephone services and various other services. However, following the war as people began to prosper they began to demand more services, including high-quality telephone service.

Much pressure was generated at the local level to upgrade service, despite the fact that we had no capital with which to do this job. We then turned to REA for help. Over the years we have received financing from both REA and the Rural Telephone Bank.

I came here today also to tell you that there are many REA-financed telephone companies serving rural America who are gravely concerned about the future of our companies and the people we serve. As Mr. Peterson has pointed out, this industry is undergoing traumatic change, and it is absolutely imperative that the REA keep pace with the changes which are taking place in the industry. The bill which you have before you for consideration contains the necessary ingredients to enable REA to keep up the pace.

There is one point that I would like to emphasize very strongly, and that is, I do not agree with those who say that the job is done in REA and, therefore, private financing in the marketplace can take over. The average net worth of these REA-financed telephone companies is approximately 26 percent. My experience taught me long ago that banks, insurance companies, and other lenders do not want to talk to you about borrowing money unless you have at least a 40-percent net worth.

I have watched the changes in the act over the past 30 years or so, how the small companies have carried out the mandate of Con-

gress to bring modern telephone service to rural America, and how these companies have been able to graduate to the higher rates of interest as their financial ability improved. However, I must tell you that in my judgment there has never been a time when the REA telephone program needed to be modernized and brought up to date as at this time. If we are to continue to carry out the mandate of Congress, this must be done.

I am proud to have been a part, over these 30 years or so, in carrying out that mandate. I want to personally thank this subcommittee for the leadership it has displayed over the years to make this possible.

Thank You.

Mr. PETERSON. That concludes our testimony, Mr. Chairman. We would be pleased to answer any questions if we can.

Mr. JONES of Tennessee. Thank yo very much, Mr. McClelland, for your statement.

Harold, if you all can stick around after one more testimony, we will call all of you back to the witness table.

John, we appreciate your being back. You are a familiar figure around here. John O'Neal, for the benefit of some of you who may not know it, he was counsel to the full Agriculture Committee for a long time around here. We are delighted that you are here, John.

Mr. O'NEAL. Thank you, Mr. Chairman. It is certainly my pleasure to be here, and I will be happy to try to answer any questions.

Mr. JONES of Tennessee. Thank you.

Our next witness and, as far as I know, the final witness for the afternoon is Mr. James W. Damon of Mount Vernon, Oreg., for the U.S. Telephone Association here in Washington, commonly known as USITA.

Mr. Damon, we are delighted that you are here.

Mr. DAMON. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Do yo have anybody with you? Are you by yourself?

Mr. DAMON. No, sir, I am by myself.

Mr. JONES of Tennessee. I see. You may proceed.

STATEMENT OF JAMES W. DAMON, PRESIDENT, OREGON TELEPHONE CORP., REPRESENTING THE UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION

Mr. DAMON. This is my first experience at ever testifying before a congressional committee as well, so it is a little nervous to be by myself.

Mr. JONES of Tennessee. Well, just consider that you are at home and make yourself at ease.

Mr. DAMON. Thank you, sir.

Mr. Chairman and members of the committee, my name is James Damon. I am president of Oregon Telephone Corp. from Mount Vernon, Oreg., and I am appearing before you as a representative of the United States Independent Telephone Association. I currently serve as a member of the REA Borrowers Committee of that association.

I want to thank you for this opportunity to be here. Mr. Chairman, in the interests of brevity I would like to ask that the full

text of my testimony, which you have a copy of, be entered into the record and that I be permitted to simply make a brief presentation to the committee.

Mr. JONES of Tennessee. Without objection, the entire statement will become a part of the record and you may summarize.

Mr. DAMON. Thank you, Mr. Chairman.

My company is one of some 1,432 independent, or non-Bell, telephone companies in our Nation. I am also well acquainted with the word "rural." We serve an area 165 miles east to west—that is roughly the distance from Washington, D.C., to New York City—yet we only have some 1,300 telephone customers. I am also well acquainted with what the REA program has accomplished for rural America through its financing program for telephone companies.

When my company first investigated the REA program in 1950, we operated three small rural magneto or crank-type telephone exchanges. Long-term commercial financing was nonexistent to our financial picture. The REA program gave us the only opportunity available to bring modern telephone service to our truly rural area at affordable rates that make service available to all. I might add that the program has had the important side effect of making us a valuable contributor to the economy of our area, as well as to its tax base.

It is important to know and remember that the REA program only makes funds available for the construction or extension of communications facilities. It does not provide operating capital. Yet in the 34-year history of the program approximately \$1 billion has already been repaid, and there has never been a default. This is truly a record of which Congress, those responsible for administering the REA program, and the telephone company borrowers can truly be proud.

The telephone industry is currently undergoing unprecedented and dramatic change. On January 1, 1984 the court-ordered divestiture by the American Telephone & Telegraph Co. of its regional operating companies is to occur. Also on January 1, 1984, the access charge order mandated by the Federal Communications Commission is scheduled to be implemented. In addition, our industry is witnessing almost unbelievable technological change. This is an exciting time to be involved in the field of telecommunications but it is also fraught with monumental change, and in a capital-intensive industry like ours these changes are also creating monumental problems.

We believe that the changes in the Rural Electrification Act proposed in H.R. 3050 constitute responsible and needed improvements in the REA program. They are particularly vital to the successful operation of the telephone program. In addition, we believe this legislation is a sound approach to the problems of the imbalance in the Revolving Fund. It is certainly the alternative least costly to my Government if we are to maintain a viable REA program and a fiscally sound Revolving Fund for the future.

In addition, it is our view that there will be a number of consolidations as we regroup to maintain financial solvency in the new environment mandated by the FCC. There are a number of provisions and housekeeping amendments to the REA Act in the legislation which will make these changes easier to accomplish.

Mr. Chairman, you have already heard much testimony about the provisions of H.R. 3050, and I would simply like to conclude by pointing out that we believe that this bill will strengthen and enhance the loan programs of REA. Just as important, it will signal to those living in the rural areas that Congress is not abrogating its commitment made long ago when it originally established the REA program—that those living in the sparsely populated sections of our country will continue to have the dependable and affordable utility service so vital to their well-being.

I want to thank you for allowing me a few minutes to present my views and those of the U.S. Independent Telephone Association in favor of H.R. 3050.

[The prepared statement of Mr. Damon appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. I thank you very much, Mr. Damon. We appreciate your being here, and if you will remain just where you are, we will call all the other witnesses who have been heard to the witness table.

I wonder, before I do that, if there is any other witness in the audience that has not been heard? Our list doesn't show that there is anyone else to be heard.

If not, you gentlemen—Mr. Hogan, Mr. Fullarton, Mr. Vellone, Mr. Peterson, Mr. McClelland, Mr. O'Neal, and Mr. Damon—I am going to recognize Mr. Stenholm first this time because he has been here for the majority of all the hearing this afternoon. I recognize him for the first 5 minutes, and then the ranking minority member, Mr. Coleman, and then Mr. Bedell, in that order.

Mr. Stenholm.

Mr. STENHOLM. Thank you, Mr. Chairman.

I don't know that I have any particular questions but I think that we need to replow some of the ground that many of these gentlemen have testified to today.

The first point that I would make is that, in reference to the testimony of Mr. Hunter this morning, I think we need to point out that there was criticism of H.R. 3050 but there was not a constructive alternative given. We believe H.R. 3050 is a constructive alternative.

I won't get into the specifics of my question because I am going to save that for in the morning, when NRECA testifies, but I think one very good point was made. This was by Mr. Hogan. The value of standardization of engineering and contractual requirements by REA, I think that was a very significant point that was made in justification of a continuation of a stable REA program, which is really what we are talking about.

There has been a lot of talk about forgiveness, subsidization; there have been statements made that anyone who believes that rural America can be served with electrical or telephone service without somebody subsidizing it is living in a different world. Does anyone at the table disagree with that?

There is only one way, in my opinion, that you can bring service to rural America, universal coverage or area coverage, whatever the term: Somebody has to subsidize somebody, if you are going to have service brought to all who need the service. Any disagreement? I don't see any heads shaking affirmatively.

I think that is one of the keys, Mr. Chairman, that this committee will need to take into consideration as we further determine the fate of this legislation, that somebody has to subsidize somebody, and the basic question is—and I was looking for a news article that was in this morning's Washington Post, and I don't seem to find it now, so I will save that, again, for tomorrow—but somebody has to subsidize somebody if you are going to bring service to that fellow that is 5 miles out at the same rate you are going to serve somebody that is maybe 10 connections per mile or 20, et cetera. That is a basic consideration.

What we are talking about is answering the question, not of the forgiveness of the \$7.9 billion, but of the transfer on the books of the U.S. Government of these loans or whatever you want to call them, if transferring them to the Revolving Credit Fund is going to provide for a stable loan fund or a stable loan condition so that rural electric cooperatives or rural electric telephone or electric cooperatives can make the necessary long-range planning decisions without wondering what the Congress may or may not do between now and 1993. Is that also a fair statement of an assessment of all of the testimony that has been made here today?

I think if there is any criticism that I would make it is that this is not going to cost the Treasury anything. I think we use that a little bit loosely, when we say this is the way we are going to accomplish this great miracle without anybody paying for it. I would rather, Mr. Chairman, that we acknowledge that there is going to be a cost. The cost is going to come in the fact that the Federal Government is not going to receive those payments back into the Treasury and in theory, at least, lower the amount of interest that we have to pay on debt. This is where I say somebody is going to be subsidizing somebody. I acknowledge that and I don't apologize for that.

I think that is a decision that this committee and the Congress have to make, as to whether or not it is in the long-range best interest of the United States and all of the citizenry that we acknowledge that. I believe, as I have heard at least two of you today say, that this is the most economical way for us to subsidize rural service. We can do it the way that others are suggesting, and we will pay much, much more in total dollars than we will in having a stable program whereby we can all plan our day-to-day operations.

I believe, Mr. Chairman, that that is a summary. I don't have any questions. The only thing that I would say is, I hate for us to say this isn't going to cost anything because I think we weaken our argument, not strengthen our argument, by saying it is not, even though I recognize that when we budgeted these—before I came to the Congress, when I was a rural electric cooperative manager—we fought this battle on a regular basis of annual appropriations. We were continually told that this was going to be very difficult for us, to continue to justify these expenditures out of the budget. Now we are off budget. Now we are finding that same argument.

I guess one of the things that I like about this proposal, about H.R. 3050, is when we talk about capital budgets, we talk about off-budget financing, we talk about the need of bringing everything into a budget process, we are plowing some new ground, Mr. Chairman, with this bill. I think it is going to be a model for many other

agencies, including some within the Department of Agriculture—Commodity Credit, for example—where we are going to need to take a good look at capping the expenditures and telling those individuals who are the beneficiaries of the various programs of the Federal Government, “We want you to manage this program, and we want you to do it within this amount of money. Here is how much it is going to be, and we want you to do a good job with that.”

I have gone over my time, Mr. Chairman, but I did want to summarize that and withhold my other comments for when we talk specifically about the rural electric program after NRECA testifies tomorrow.

Mr. JONES of Tennessee. Thank you very much, Charlie, for a very fine, constructive statement.

Now I yield to my good friend, Tom Coleman.

Mr. COLEMAN. I think most of you were present this morning when Mr. Hunter was here, and he had his charts and his computer man with him and so forth. They had one chart which indicated that in one scenario we do nothing, and you can see the curve fall and the Fund go belly-up or just go into bankruptcy basically, a little bit. They had another one which was supposed to be this bill, and that kind of fell too. Another line that he talked about is one scenario where if you increase the interest on the Revolving Fund to 9 percent—that was the factor that they had there—that it goes on into the future, long term, in pretty good shape.

I asked him what the effect on consumers would be if it went to a 9-percent figure, and the response was that for every 1 percent increase in the Revolving Fund, that it translates into one-half cent a day increase to the consumer. That is not a whole lot of money if that is, in fact correct, by raising it from 5 to 9 percent.

I would like to have you comment on that answer, and if you don't agree with that answer, what figures would you plug-in to show an increase to consumers if it went to a 9-percent figure on the Revolving Fund?

Mr. VELLONE. That figure, of course, depends on the assumptions made. A lot depends on the size of the system and the existing indebtedness that must be considered. It varies up and down, depending on the individual circumstances. Like the old saying, “We can all drown in 2 feet of water,” the same thing pertains to averages of this nature.

Mr. O'NEAL. I would like to add also, Mr. Chairman, that the Administrator did not make it clear whether or not he was referring to electric or telephone rates or both. Frankly, Mr. McClelland and I discussed that matter over lunch today, and his company had made a study last year based on potential rate increases on a loan that they received from REA. With the indulgence of the committee, I think it might be important for him to address that question.

Mr. JONES of Tennessee. Mr. McClelland.

Mr. MCCLELLAND. Yes, sir. About a year and a half ago we received a \$10 million loan from REA to upgrade some of our facilities and put a digital switch in our largest exchange at Bolivar, Mo. Now what Mr. O'Neal refers to is, I quickly estimated that if we were paying 5 percent more interest on that money, this would amount to about \$3 per month on each customer's telephone bill.

Mr. COLEMAN. The Administrator said this morning that that was telephone and electric. I asked him that and he said that it was a combined figure.

If you look at one of their charts which shows two of those lines become insolvent—this is if nothing happens, this is if this bill passes—the other line that they don't show here, which we asked them to supply to us, goes up here and goes off the chart, and that was the 9 percent or 2 percent below the CBO figure, assumed 11 percent, down to 9 percent. Now he has down here: "Assumes 11 percent CBO rate; no growth; no forgiveness; and CBO's amortized."

Now I am asking you to refute his statement about the 1-percent increase in interest rates translating into one-half cent a day. This is what I want to hear, what I want to ask. Bob has just mentioned some study they made for his company, but I am asking for the Nation. Is he telling us the truth, or is it incorrect with these assumptions?

Mr. VELLONE. The answer depends on the assumptions made. We could supply examples for the record contradicting that statement.

Mr. O'NEAL. I think, too, Mr. Chairman, that we find ourselves in basically the same position as the committee finds itself. This is the first time that we have seen these charts, and we have not had the opportunity to study them. I would suggest that when you start talking about doubling the interest rate, particularly in the telephone business, you are talking about significant rate increases. When you add those to the already existing burdens that are going to be placed on individual rate payers, particularly in rural America, after the first of next year, you are talking about significant amounts of dollars.

Mr. VELLONE. Also overlooked, for the record, is the fact that these borrowers in both the electric and telephone program do get considerable portions of their financing from other sources—from the supplemental financing source, CFC, in the electric program, from the Rural Telephone Bank in the telephone program—and these factors do not consider the present burden, which is a lot more than the assumed 5-percent base that as given this morning.

Mr. COLEMAN. Well, I would like to have somebody from your groups supply me information so that I know what the answer to that question is. If we are talking about, under the answer Mr. Hunter gave, increasing the consumer rates \$7.30 a year, I think we have better things to do than worry about \$7.30 for a whole year. If you have other figures based upon their assumptions or other assumptions that are more realistic, I would like to have those as soon as possible.

Mr. FULLARTON. Congressman, NTCA would be happy to supply examples of the impact of increasing interest rates on rates to telephone subscribers. It must be recognized, however, that an average in this case really doesn't mean a whole lot; that every situation is different. We will attempt to supply you with a broad range of examples of the impact of interest rates on existing REA borrowers and their operations.

Mr. COLEMAN. Thank you.

Mr. JONES of Tennessee. One question, Dave: Let me ask you, the information that you would be supplying us would be from telephone co-ops only?

Mr. FULLARTON. Both co-ops and commercial borrowers. We would attempt to get examples from both types of corporate entity.

Mr. JONES of Tennessee. Will that be broken down so we can see the difference?

Mr. FULLARTON. If you wish.

Mr. JONES of Tennessee. I think it would be good to know.

Mr. FULLARTON. What we would have to do—the question is so difficult that we don't make assumptions of the kind that allow broad averages to be floated because they are invariably misleading, invariably. Therefore, what we would do is, we would give you a range of sample operations of rural telephone systems, regardless of corporate structure.

Mr. JONES of Tennessee. I think what Tom is asking for is something that is really important to us, that we have that information. We are not going to markup tomorrow, anyway, or day after tomorrow, so we need to have that information if we can, and from some of you other people too—Harold, from your association—USITA.

Mr. PETERSON. We would be happy to do that.

Mr. JONES of Tennessee. We would be glad to have it from any of you that we can obtain it, just so it is authentic.

Charlie, did you have something?

Mr. STENHOLM. I will just say I am quite certain that when NRECA testifies, they will be giving this same—

Mr. JONES of Tennessee. Yes.

Mr. STENHOLM [continuing]. In fact, I see Mr. Partridge out there—that they would be prepared to do that in the morning, and show the difference in systems. I think the point that has been made is a very pertinent one. When you argue the averages it doesn't mean a whole lot. How it affects individual systems is going to be the message that is going to come through to us when we see those figures.

Mr. JONES of Tennessee. Bob Partridge, would you have that type of information for the electricians when your group testifies?

Mr. PARTRIDGE. I will be prepared tomorrow, Mr. Chairman.

Mr. JONES of Tennessee. Very good.

Mr. Bedell, do you have something? You are recognized anyway at this time.

Mr. BEDELL. Many of us are wrestling to try to understand this whole thing as well as we possibly can. Do I understand it correctly that if I am a borrower—I have a small local telephone co-op—I can borrow either through a direct loan or a guaranteed loan? Is that correct?

Mr. VELLONE. The guaranteed loan is available for almost any borrower that can meet the loan guarantee rate. The other type of loan depends on whether or not the borrower meets the particular qualifications for that particular program. That is, there are statutory criteria for the 5 percent standard program and there are statutory criteria for the Rural Telephone Bank program.

Mr. BEDELL. However, my understanding is that most of the dollars that are loaned are loaned under the guaranteed program. Is that correct?

Mr. VELLONE. That is true in the electric program; it is not true in the telephone program.

Mr. BEDELL. Oh, it is not? OK.

Do I understand further that really what is happening, what the proposal is, if we take the amount of money that has been borrowed, if we indeed forgive the requirement to repay that to the Government and make it then a revolving fund, that you will be able to take the payments which I as a small telephone company make back to the fund, which consist of interest and payment on principal, take the total of those two and use that, then, to pay for the interest charges that I have on any CBO's that I may borrow. Is that the way this will work under this new bill?

Mr. VELLONE. Well, the new bill is not any different from the old bill in this respect. This is a revolving fund. It recycles the collections of interest and principal to take care of the immediate needs of making advances on new loans and to pay existing interest. In recent years the collections on loans that have been made do not provide more than about half of the cash requirements, and the program is designed to permit the collections to be supplemented by borrowing from outside sources or from the sale of the Fund's assets under CBO's. That is part of the Revolving Fund plan.

Also overlooked in all of these discussions about doing nothing is the fact that there is authorization right now, today, for appropriations for interest subsidies and losses. There is also authorization in the present law to borrow for other purposes than just to make advances on loans; to meet any of the Fund's obligations, including borrowing to refinance existing obligations.

Now the important thing of doing something about these notes in the future is to stabilize the requirements for interest coverage in that critical period. These notes, which have been expended a long time ago—water under the bridge, as you might say—the payment of those has to come from someplace.

The Fund gets money only from its collections and from borrowings from the outside world, so to meet existing obligations of this nature it would just roll them over, like any commercial enterprise does, like the commercial utilities do. It is not within the function of these utilities to actually ever pay off a debt, except by new borrowings. It is the exception rather than the rule, and that was overlooked entirely in this morning's discussions.

Mr. BEDELL. I don't want to be disrespectful, Mr. Vellone, but I am trying to find something out and I wish you would consider that we are not too intelligent up here. This long dissertation frankly did not help me a bit in trying to understand what I am trying to understand. We are friendly toward what you folks are trying to do, but if we are going to understand it we have to have some short answers to the questions that I am trying to ask so I can understand the problem.

The problem I have is, I am trying to understand how this bill will work, if it works, and to understand what problems there might be out into the future. Is it correct that the bill, in simple language for simple people, would say that if I am operating a local

telephone service, that I will continue to make the payments that I have committed to pay, which are interest and principal on the loan that I have borrowed, but that the Administrator will simply take those total payments and what he will need to do under this legislation is pay the interest amount due from the borrowings that they make. Therefore, he will have interest and principal to use to pay the interest that he owes. In simple terms, is that really the way this works?

Mr. VELLONE. Yes.

Mr. BEDELL. OK. That is tremendous. If that is the way it works, then the question that I would ask is, how long are the principal payments generally, and is there a chart to show what those annual principal payments are anticipated to be over the next few years? I assume that what is really happening, if I understand it, is that we are going to use the principal payments in order to subsidize the interest.

If that is the case, then the amount of principal payments is going to be critically important. If those are going to drop off significantly in the future, then it appears to me the necessary subsidy is going to drop off significantly in the future and we are in trouble. If those are going to increase in the future, then it looks to me as if the interest rates could be expected to go down in the future. Is there a chart that would show what those receipts, those principal receipts, are expected to be?

Mr. VELLONE. I think REA has prepared charts over the years, but the important point to make is that—

Mr. BEDELL. Before you give the point, is that available? Is that chart available to the committee?

Mr. VELLONE. I do not have such a chart but I am sure that REA has.

Mr. BEDELL. Well, at least this committee member would appreciate very much receiving it, because it seems to me that is a critically important thing as you look at where you are headed in the future.

Now I interrupted you. You may go ahead.

Mr. VELLONE. Yes. The point I would like to make is that there are no restrictions on the receipts into the Fund. The receipts into the Fund, from whatever source, are intermingled with all other receipts of the Fund and are used for all purposes of the Fund. In other words, interest collections are not restricted to making interest payments; principal collections are not restricted to making principal payments. The Fund—

Mr. BEDELL. There won't be any principal payments any more by the Fund, will there?

Mr. VELLONE. Well, there would be the equivalent of principal payments if the principal payments are applied to, say, these notes—

Mr. BEDELL. New notes.

Mr. VELLONE [continuing]. To new notes and also to the CBO's.

Mr. BEDELL. However, what we are doing is, we are saying that—I don't want to take too much time—we are saying that the individual borrower will still make principal payments on the loan that he has, but that it will not be necessary to make those principal payments back to the Government because those will be forgiv-

en and made a part of the Revolving Fund, of the loans that have already been made.

Mr. VELLONE. No.

Mr. BEDELL. Well, if that is not correct, then we will talk about it later sometime and you can explain it to me.

Mr. FULLARTON. A note in addition: We have just passed a note, and NRECA has the chart of principal payments and will submit it tomorrow morning to the committee, if that is satisfactory.

Mr. O'NEAL. Also, Mr. Bedell, on page 11 of Mr. Peterson's testimony I think it shows the information that you want, at least up it through 1982. It is not a projection of anticipated repayments but it does show what the repayments to the Fund have been, in both principal and interest, from its inception through 1982, as well as the outlays of advances to borrowers and interest paid during that same period. What you might want REA to do would be to extend those projections into the future.

Mr. JONES of Tennessee. Thank you, Mr. Bedell.

Thank you, gentlemen.

Mr. Weaver, do you have any questions?

Mr. WEAVER. Not right now.

Mr. JONES of Tennessee. OK. All right, we are about to finish here.

Does any member of the subcommittee have more questions at this point?

[No response.]

Mr. JONES of Tennessee. I have two or three I want to ask. Let me ask this august body a question or two that I would like to ask, and I am asking it to the group so anybody can answer that would like.

In my congressional district and throughout the area that I am quite familiar with, people are really outraged about paying increases in telephone rates right now. In fact, every time I go home that is what I hear more about than most anything else. My question to each of you is, what impact will the passage of H.R. 3050 have on future telephoe rate increases, if any?

Mr. FULLARTON. Mr. Chairman, as a very broad statemnt, the passage of this legislation will of necessity stabilize borrower operations and keep interest rates as low as they are feasibly able to be. Thus, they will hold down rate increases. That is an overall generalization.

Mr. JONES of Tennessee. You are generalizing by saying that if the Fund is used, Dave, by the various telephone companies, that it will assist in being able to make the services better and being able to make it more efficient, to hold down rates?

Mr. FULLARTON. Yes. By stabilizing and holding in relative stability the interest coverage requirements for improvements in plant and extensions of plant, it has to have the effect of stabilizing rates or holding them down.

Mr. JONES of Tennessee. Do the rest of you gentlemen agree with that?

Mr. PETERSON. Well, what is sought in the bill, in addition to what Mr. Fullarton has indicated, is that some of those provisions will enable the companies to do in a competitive environment that which they cannot do today. We are told that we have to be more

competitive, and yet there are certain constraints placed upon the REA telephone borrowers that work against that objective. Therefore, there are some provisions in H.R. 3050 affecting the telephone segment that allow us more flexibility to do what Mr. Fullarton has just indicated, and it is sorely needed.

Mr. FULLARTON. Mr. Jones, we are telling our members, as I think you may be aware, that we are looking at our entire revenue base being eroded in the years ahead from a variety of circumstances within the industry, and that they have to look for other sources of revenue to hold down those basic kind of telephone rates. We call that diversification, amongst our telephone systems, and I referred to that in my testimony.

Particularly the lien accommodation provisions of H.R. 3050 would allow us to diversify, seek other kinds of financing for those services, and thus offset the otherwise erosion of the revenue base and hold down rates even more significantly, as Mr. Peterson points out.

Mr. JONES of Tennessee. Well, now, if the Reagan administration prevails and H.R. 3050 is not enacted, will future rate increases be more or will they be less?

Mr. PETERSON. Well, I don't think there is any doubt that future rate increases are going to be more. Everybody in this country is going to get increased telephone rates by reason of the FCC action. Mr. Alfred Kahn says that this is good. He said the way the system had been run before is no good. It goes against his pure economic theories.

I had the dubious pleasure of listening to the professor from Cornell out in Denver in August. I was sitting as close to him as McClelland is, when he said in the presence of Jack Keene from New Mexico that if they had done things the way he wanted to do them, instead of there being 94 percent of the households in this country with telephones there would only be about 86 percent. He implied that this was good because it satisfied his pure economic theories, but then, you know, he also said something else. He said, "But there is a problem in rural America." He admitted that.

As a matter of fact, the Rocky Mountain News, the following morning after he made that statement—and I have a copy of the article—it says: "Fewer in U.S. To Have Phones, Kahn Says." Well, if you applied pure economic theory to telephone service in rural America, no one would have telephone service, which goes right back to the statement that Mr. Stenholm made earlier.

Mr. FULLARTON. Mr. Chairman, in reference to Mr. Stenholm's comment, there are really two major reasons why telephone service today in rural America is both reliable and affordable. One is the REA program, and the other is what has been the structure of the nationwide network.

Well, related to the divestiture and specifically to the FCC access charge decision, the network is no longer planned to provide the kind of support to universal service for residential and rural subscribers that it has in the past. With that gone, as Harold says, everybody's rates are going to rise. There is a particular problem in rural areas because of the high cost to provide service.

If in any way the REA program and its future is brought into jeopardy, we have a real disaster on our hands in terms of provid-

ing communication service in rural areas. Mr. Kahn's estimate of the decrease in the people who will be able to afford reliable service is, I think, a little weak. I think it is much higher than that. Therefore, with the changes in the industry, the REA telephone program is even more critical if our rural citizens are to be able to communicate.

Mr. JONES of Tennessee. Does any member of the subcommittee have any more questions?

Mr. BEDELL. I do.

Mr. JONES of Tennessee. Mr. Bedell.

Mr. BEDELL. I am still having some difficulty. This chart gives me even more difficulty, I guess, in trying to understand everything, because the chart would indicate that the interest received is greater than the interest paid out so far, significantly greater. My question is, under what terms was the original capital that this \$7 billion or whatever it is that we have in the Fund, under what terms was it borrowed from the Government so that we can charge 5-percent interest on the money we loan out, and take in more than what we have to pay for the money we have taken? Can that be explained easily?

Mr. FULLARTON. Probably in about four sentences but inadequately, Congressman. The Fund was structured initially to be self-supporting, back in 1973. What has brought about the dilemma that is going to occur in the 1990's is, plain and simple, the thing that has happened to all Americans—high interest rates—because the Fund borrows from the Treasury at the Treasury's rate and the FFB is borrowing short term. If money is 18 percent, they are paying 18 percent; if it is 10 percent, they are paying 10 percent, and this is what the Fund has to pay out. Therefore, the stability of the Fund was based on the prediction of what interest rates will be.

Mr. BEDELL. Well, have they borrowed quite a lot of money at less than 5 percent?

Mr. FULLARTON. No.

Mr. BEDELL. If they haven't, I don't understand how they can take in—if they are paying more than 5 percent on the money they are loaning—I don't understand how they can charge 5 percent and collect more than they are paying.

Mr. VELLONE. The situation is this: The REA Revolving Fund collects interest at 5 percent maximum from all of the borrowers on all of the outstanding loans.

Mr. BEDELL. Right.

Mr. VELLONE. It pays interest on only part of the capital invested in these loans.

Mr. BEDELL. Why?

Mr. VELLONE. Because part of the capital invested was already invested before 1973, and the interest on those notes that we have been talking about was extinguished in the 1973 amendments, so that a large portion of the loans on which REA receives interest require no interest to be paid. As of the moment, the total interest income exceeds the total interest expense of the Fund.

Mr. BEDELL. That explains it, but can you give me some idea of what those figures are? We are talking about here, as I understand it, transferring something on the order of \$7 billion or so out of

loans into the Fund. Is this money you are talking about in addition to that? Was there a big amount previously put into the Fund?

Mr. VELLONE. In my prepared statement I indicate what went into the Fund at its start in 1973.

Mr. BEDELL. Was that a large amount?

Mr. VELLONE. It was a large amount of existing loans receivable from the borrowers. They were transferred over into the Fund, with the authority for the Fund to use the receipts, principal and interest, for the purposes of the Fund, whatever they may be—to make new loans, to pay interest on loans, to cover the obligations of the Fund.

Mr. BEDELL. About how much was it?

Mr. VELLONE. It is—no, it is larger than that.

Mr. BEDELL. Roughly.

Mr. VELLONE. Yes. It is right here.

Mr. BEDELL. My question is, Is it \$1 billion or \$10 billion or \$5 billion?

Mr. VELLONE. The total amount is \$7,802,780,918, of which—it is on page 3 of the statement—of which \$6.5 billion plus is the outstanding notes payable by electric and telephone borrowers to REA.

Mr. BEDELL. Yes.

Mr. VELLONE. Then there was \$882 million of undisbursed balances of electric and telephone loans. These are loans made but not disbursed. It takes an average of 2 or 3 years to disburse a loan after it has been made, and these were the funds that were available to be disbursed on the loans made the year before and the year before that.

Mr. BEDELL. This doesn't apply to my question. I thought you told me that in 1973 there as a sizable amount of money put into the Fund by the Government and that that is money on which you don't have to pay interest. I thought that is what you said. My question is, Is that a sizable amount or is that insignificant?

Mr. FULLARTON. The amount put in was primarily in the form of receivables.

Mr. BEDELL. OK. I don't care what it is. I want to know how much it was. Is it a big amount or a small amount?

Mr. VELLONE. That is represented on the liability side of the balance sheet, and that was \$7,408,638,000.

Mr. BEDELL. Oh, so \$7 billion was put in previously. We are talking about doing something similar with this legislation. Is that correct?

Mr. VELLONE. This is an existing liability. No new money was put into the Fund at that time.

Mr. BEDELL. No, no. No, no. We have two things. We have capital given to the Fund and we have loans loaned to the Fund. Is that correct? In 1973 capital was given to the Fund. Is that correct?

Mr. VELLONE. About 5 percent of the total was equity capital at the time. About 5 percent of the total was equity capital. The loan made the Revolving Fund liable for \$7,408,638,673 of notes issued by REA to the U.S. Treasury from August 14, 1953, through March 19, 1973.

Mr. BEDELL. I think I am wasting everybody's time but I just have to tell you my concern. My concern is that I don't understand

how you can borrow money at 11 percent, loan it out at 5 percent, and take in more than you loan out. When I find out how to do that, I am going to go into the business, and I have a lot of farmers who would like to come and see me. [Laughter.]

Maybe when I get back to my office or sometime, somebody can explain to me how that works. I won't take any more of the subcommittee's time trying to find it out now.

Mr. O'NEAL. What may be misleading you, Mr. Bedell, is the fact that the Administrator referred to the fact this morning that the \$7.8 billion was put into the Fund in 1973 as seed capital. Frankly, that is not correct. Those notes already existed. The money had been lent out to individual rural systems, telephone and electric.

Mr. BEDELL. Is there any interest on it?

Mr. O'NEAL. Sir?

Mr. BEDELL. Is the Telephone Revolving Fund paying the Federal Government interest on that?

Mr. O'NEAL. No, sir. By statute there is no interest due on those notes. Those notes, however, were put into the Fund as liabilities of the Fund, even though they didn't come due until 1993 through 2017. However, that was not seed capital. What we are asking now is that those notes be made capital of the Fund.

Mr. BEDELL. However, what I understand has been happening in reality, if I understand it correctly, is that you have been loaning the money out to borrowers and telling them that they are supposed to pay interest and principal on it, but you are not paying any principal. You are only paying interest. Isn't that correct?

Mr. O'NEAL. No, sir.

Mr. STENHOLM. Mr. Chairman, let me take a stab at it.

Mr. JONES of Tennessee. Mr. Stenholm.

Mr. BEDELL. Forget it.

Mr. STENHOLM. No, let me take just a couple of seconds, Berk, and maybe we can help you understand it.

In 1944 was when Congress first amended the law to begin providing for the 2-percent loan fund. In 1973 the Congress had appropriated almost \$8 billion—\$7 something—let's say \$8 billion that Congress, prior to 1973, had appropriated for REA. In 1973, in the wisdom of the Congress we set up the new program which provided for the Revolving Fund concept.

Now there was about \$500 million seed capital that was provided. The rest of it was just a shift on the books of money that was already owed, that was put on the balance sheet as a liability to the Fund.

Mr. BEDELL. All right.

Mr. STENHOLM. Now the problem has come because we specified in the Congress that we were going to loan it at 5 percent. Well, interest rates have been higher than that, so as we were loaning it at 5 percent, we were not getting enough in repayments to keep the Revolving Fund going. Therefore, there was created a CBO—certificate of beneficial ownership—in which the Revolving Fund went into the market and borrowed the money at the going rate, which was whatever it cost the Government to make these loans since 1973.

What we were making these loans for, and the difference in the interest, is what has depleted the Revolving Fund. That is why, if

we don't change the interest rate we are charging and we don't have this additional influx of seed money—and we are really talking about some money of \$7.9 billion, is what I am saying now—what we have to do now is recognize you cannot do what you just said. You cannot borrow it at 11 percent, which is what the Fund was doing, and loan it out at 5 percent without using up your seed corn. That is what we have been doing.

Mr. JONES of Tennessee. Well, we have one more—

Mr. STENHOLM. Mr. Chairman, let me make one additional comment.

Mr. JONES of Tennessee. OK.

Mr. STENHOLM. I can appreciate the confusion of anyone because I have to admit, even though I spent 9½ years in the program, it is difficult sometimes to understand totally what we are talking about.

Let me make one other point. We have our telephone cooperative people before us today. You know, in 1937 any one of your members or your customers or my constituents, if you happen to be from Texas, could telephone me or the chairman or Mr. Bedell and tell us what you thought about this bill. In 1937 for \$9 you could call and talk to us for 3 minutes, or you could mail us 450 letters and tell us what you thought about this piece of legislation or any other piece of legislation. Today, for that \$9 you can phone us and talk to us and try to explain the position, talk to us for a little over 20 minutes, but you can only mail us 45 letters.

You know, guess which one the regulatory bodies, the courts, which body it is being suggested is abusing the consumer? If we stop and think what is happening to us in some of this debate, and it has gone way further than what I think this committee or anyone else would recognize, it is the same thought process that comes in and says that rural electrification has done its work and there is no longer or need for a "subsidy." It is kind of like the same city officials coming up and telling us they don't need revenue sharing.

My last point is, we approved for the next 3 years about \$15 billion in revenue-sharing funds, which is a direct appropriation out of the Treasury. The bill we are talking about today, which is not a forgiveness bill—it is just a paper transaction on the books of the U.S. Government, to which it is going to be paid back—is \$7.9 billion over the next 30 years. That is the dollar relationship of what we are talking about.

Mr. JONES of Tennessee. A fine statement. Thank you, Charlie.

I want to thank everybody who has been here this afternoon, for your attention and your time and for the testimony that you have offered. You have done a good job, and we appreciate it very much. We are not ready for a markup. We are going to have tomorrow. We will meet again in the morning at 10 a.m. The subcommittee will stand in recess until that time.

[Whereupon, at 4:15 p.m., the subcommittee recessed, to reconvene at 10 a.m. on Wednesday, October 5, 1983.]

[Submitted material follows:]

TESTIMONY BY
THE HONORABLE TOM RIDGE(Pa)
SUBCOMMITTEE ON CONSERVATION, CREDIT,
AND RURAL DEVELOPMENT

October 4, 1983

Thank you, Mr. Chairman. I appreciate very much the opportunity to appear today before your subcommittee to speak in favor of H.R. 3050, the proposed amendments to the Rural Electrification Acts.

Although I will have some comments on the specific provisions of this legislation later in my testimony, I will leave detailed analysis of the bill to other speakers who will appear before you later today and tomorrow.

At the outset, I believe it is important to review the reasons why the Rural Electric financing programs were established, and why they are still important today -- important to the residents of the 21st congressional district of Pennsylvania which I represent, Mr. Chairman, and indeed, important to millions of Americans who live in rural areas all across our country.

In a very real sense, May 11th, 1935, was a major turning point in the development of this nation's rural areas. On that date, President Franklin Roosevelt signed an executive order that established the Rural Electrification Administration. REA was intended to provide low interest loans to anyone who would extend electric service into rural areas. In almost every case, however, it has been non-profit, consumer-owned rural electric cooperatives that have done the job.

Ridge testimony
page two

From the very beginning, Rural Electrification has received strong bi-partisan support within the Congress. It has received this support because of the challenges it has overcome and the leadership it has provided in the electric utility industry.

This bi-partisan support is manifest in the co-sponsorship of the amendments to the Rural Electrification Act that are before this distinguished subcommittee today. I am proud to say that my own state of Pennsylvania has contributed more co-sponsors to this legislation than any other state. Nineteen of our 23 representatives, and both of our senators are co-sponsors of this bill or its counterpart in the Senate.

Until the end of 1972, loans made by the Rural Electrification Administration were funded by money received from the Treasury as a result of annual authorizations. Two new financing programs were established in 1973, an insured loan program and a program of loan guarantees. Neither of the current REA financing programs rely on taxpayers' dollars. They are not part of the federal budget and do not contribute to the federal deficit.

The changes that were made a decade ago substantially increased the cost of financing rural electric construction programs. But those changes were made with full cooperation, participation, and support of rural electric leaders.

When it became apparent that changes would have to be made in the rural electric financing programs, especially the insured loan program, rural electric leaders again showed their forthright and cooperative attitude.

Ridge testimony
page three

The legislation currently before this subcommittee is largely the result of the work of a "Blue Ribbon" panel of rural electric leaders including several past REA administrators.

Mr. Chairman, we are not being asked to enact a crisis program. We are not being asked to provide a bail-out. Nor are we being asked to act without the benefit of a thorough investigation of all the facts associated with this matter. The approach rural electric leaders have asked us to take to address the problems associated with their program is, in my judgement, a prudent one.

To this point, I have spoken generally about the history and justification for federal involvement in the rural electrification program. In addition, I have addressed the current challenges that face the REA financing programs and the proposed response to these challenges that has been outlined by REA leaders. I would now like to turn to a specific provision of H.R. 3050 -- perhaps its most controversial provision.

This provision would convert notes payable by the REA Administrator to the Treasury into permanent capital of the Rural Electrification and Telephone Revolving Fund. The notes were executed during the days of the old REA direct loan program to convert congressional authorizations into the actual funds that were lent to rural electric cooperatives. This provision does not, in any way, alter the obligation of rural electric cooperatives to repay their loans to the federal government. It does, however, provide the revolving fund with a stable source of funds for future operations.

Ridge testimony
page four

This is not a revolutionary proposal. This technique has been used by the federal government on at least two other occasions, once with the St. Lawrence Seaway Corporation, and another time with a special revolving fund in the Department of Energy. Private corporations, as you know, Mr. Chairman, use this technique every day. Through the use of convertible debentures, private corporations convert debt instruments like bonds into assets like common stocks.

That is exactly what is being proposed for the Revolving Fund. Debt instruments -- the notes from the REA Administrator to the Treasury -- are being converted into assets -- capital in the fund that would be owned by the federal government. This is not a give-away because nothing is being given away. The money represented by the notes from the Administrator to the Treasury is currently owned by the federal government; and the money that will be represented by the capital in the revolving fund will also be owned by the federal government.

There are five points I believe the Subcommittee should remember as it moves forward with its consideration of H.R. 3050:

First, the work of rural electrification is not completed. There are always new consumers to be served and old lines to be brought up to modern standards.

Second, the challenges facing rural electric cooperatives today are much as they were almost a half century ago when REA was established. Rural electric cooperatives still serve the most remote, most rugged, and most sparsely settled areas of the nation.

Ridge testimony
page five

Third, the rural electric financing programs represent an attempt by the government to establish equitable levels of federal assistance (ot) the various forms of ownership in the electric utility industry.

Fourth, rural electric cooperatives merit continued federal assistance because of their remarkable record of fiscal integrity. The repayment record of rural electric cooperatives has been second to none with defaults totaling less than \$50,000 out of the \$35 billion of loans and loan guarantees that have been made during the last half century.

And fifth, all Americans have a stake in keeping the electric rates paid by our nation's farmers and ranchers at reasonable levels. The price of food to consumers in our cities and towns is directly related to the cost of the electricity farmers and ranchers use to assist them in their work.

Thank you, Mr. Chairman and members of the Subcommittee, for this opportunity to comment on H.R. 3050. I hope the Subcommittee will move forward to report this important measure in a timely fashion. This legislation means much not only to my own constituents in northwest Pennsylvania, but also to millions of other Americans who live in rural areas throughout our entire country.

Thank you.

TESTIMONY OF CONGRESSMAN WILLIAM F. CLINGER, JR.

Thank you Mr. Chairman. I appreciate this opportunity to appear before the Subcommittee to speak in favor of H.R. 3050, the proposed amendments to the Rural Electrification Acts.

Almost 50 years ago, in the area surrounding the towns of Warren, Brookville, and Parker, Pennsylvania, and in areas throughout the United States, rural people lived lives full of darkness and drudgery. Unlike their cousins who lived in town, these rural residents did not have the benefit of central station electric service. As recently as 1935, only 24 percent of the farms in Pennsylvania had electric service. For the nation, the figure was only ten percent.

In my area, the first rural electric cooperative was established in 1936. In a very real sense, farmers and their rural neighbors who had been deprived of electric service came together to form their own electric utility. They used loans from the Rural Electrification Administration to run electric lines over the hills and across the valleys to bring light, and power, and music to their homes. By doing so, they entered the 20th century and, at long last, they took their place along side their city cousins as first class citizens.

From 1935 to 1972, rural electric cooperatives received low interest loans from REA that were directly funded by the federal treasury as the result of the annual authorizations. In 1972, Congress replaced the direct loan program with two new financing programs; a program of loan guarantees designed to assist in the construction of power supply facilities and a program of insured loans primarily designed to benefit rural electric distribution cooperatives.

The REA guaranteed and insured loan programs that Congress established a decade ago have generally worked well. There are storm clouds on the horizon, however, The unprecedented interest and inflation rates of recent years have threatened to throw the Rural Electrification and Telephone Revolving Fund out of the balance by the end of this decade. The Revolving Fund was established as the source for new REA insured loans to distribution cooperatives. Its health

is essential to the continued stability of the financing program that benefits the almost 1,000 rural electric distribution cooperatives that serve almost 30 million Americans.

A "Blue Ribbon" committee of rural electric leaders was formed to explore potential solutions to the problems faced by the Revolving Fund. The results of the committee's work are largely incorporated in the legislation before the Subcommittee today. If enacted into law, the provisions of H.R. 3050 will increase rural electric cooperative financing costs. But, very importantly, the changes contained in this legislation will allow the REA financing programs to continue to operate well into the future.

To conclude, Mr. Chairman, I would like to review five reasons why I believe we should support this legislation.

First, the work of rural electrification is not completed.

Although rural electric cooperatives have extended central station service to nearly every farm and rural residence, there is still much work to be done. Each year, new people move into rural areas. Service must be extended to them. And many of the lines that run through the countryside are thirty or forty years old. They must be replaced in order to provide reliable and adequate service to meet the needs of today's consumers.

Second, the challenges facing rural electric cooperatives today are much as they were almost a half century ago when REA was established.

Rural electric cooperatives serve the most remote, the most rugged, and the most sparsely settled areas of the nation. A measure of this fact, I believe, is the statistic that rural electric cooperative service areas include almost 75 percent of the surface area of the United States, but cooperatives serve only ten percent of the nation's consumers. Cooperatives serve an average of only 4.7 consumers per mile of line while the private power companies serve an average

of 35.8 consumers per mile of line. Cooperatives receive revenue that averages only \$3,370 per mile of line. On the other hand, cooperatives' investments in their systems average \$1,337 per consumer as compared with only \$825 per consumer for the private power companies. It only makes sense that it will cost more to provide service in rural Warren County than downtown Pittsburgh or Philadelphia.

Another aggravating factor in my area is that as many as 50 percent of the consumers of some cooperatives are seasonal members who use their summer homes and hunting camps only infrequently. Although these seasonal members produce very little income to help offset cooperative operations, the cooperative must make the investment to have service available whenever these consumers flip the light switch.

Third, the rural electric financing programs represent an attempt by the government to establish equitable levels of federal assistance to the various forms of ownership in the electric utility industry.

Although their investment per consumer and operational costs are significantly higher than those of the private power companies, rural electric cooperatives receive substantially less federal assistance. Through accelerated depreciation allowances and federal tax credits, private power companies receive assistance from the federal government totaling about \$3.6 billion per year. Federal assistance to municipal electric systems as a result of their ability to finance their capital projects through the sale of tax-exempt bonds totals about \$331 million per year. This calculates into federal assistance to private power companies of about \$50.70 per consumer per year and to municipal electric systems of about \$40.45 per consumer per year while federal assistance to rural electric cooperatives amounts to less than \$9.00 per consumer per year.

I believe it is important to remember that almost all of the assistance received by rural electric cooperatives from their beginning has been in the form of loans that will be repaid to the federal government and not grants or tax write-offs

Fourth, rural electric cooperatives merit continued federal assistance because of their remarkable record of fiscal integrity.

Over the years, loans and loan guarantees totaling almost \$35 billion have been advanced to rural electric cooperatives. But, in the almost half century history of the rural electric financing programs, there have been only two defaults totaling less than \$50,000 with the last default taking place over three decades ago.

And fifth, all Americans have a stake in keeping the electric rates paid by our nation's farmers and ranchers at reasonable levels.

One of the primary reasons the rural electrification program was established almost 50 years ago was to increase the productivity of our nation's farms and ranches and that it has done. America's farmers are the most productive in the world. America's farmers make us the best nourished people on the face of the earth and there is even enough left over for us to help feed a hungry world. The productivity of American agriculture is, to a large extent, dependent on electrical power. As a result, the price of electricity is reflected in the price of every tomato, every steak, and every quart of milk that Americans consume.

Rates charged by rural electric cooperatives nationwide already average 14 percent more than those charged by the neighboring private power company. In my area, the rates of one rural electric cooperative are almost double those of the neighboring private power company. The rural electric financing programs and the provisions of H.R. 3050 will help to keep this rate disparity from worsening. Yes, H.R. 3050 will help moderate the electric rate increases faced by rural electric consumers. But, in a very real sense, H.R. 3050 will also help to moderate the price of tomatoes, and steak, and milk for consumers in cities and towns far from the nearest rural electric cooperative.

In conclusion, Mr. Chairman, I would like to again thank you for allowing me to express my support for H.R. 3050. I join my many colleagues who have co-sponsored this measure in urging the Subcommittee to expeditiously and favorably act on this important legislation.

Thank you.

TESTIMONY ON H.R. 3050

Submitted to the
SUBCOMMITTEE ON CONSERVATION,
CREDIT, AND RURAL DEVELOPMENT

By the

HON. HAROLD L. VOLKMER
MEMBER OF CONGRESS

Thank you, Mr. Chairman, for the opportunity to testify before your subcommittee today. I wish to voice my strong support for H.R. 3050, the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act. I am pleased to cosponsor this legislation, along with many others, including the chairman and the ranking minority member, my colleague from Missouri, Mr. Coleman.

In 1936, the Congress and President Roosevelt enacted the Rural Electrification Act. With this act, we became committed to the commendable goal of assuring our rural citizenry of reliable electric and telephone services at affordable rates. Lending programs were established to help achieve the task of making these necessities of modern living available to every citizen of this great country.

In 1973, Congress created the Rural Electric and Telephone Revolving Fund to provide a long-term source of capital for REA borrowers and allow the continued development of rural electric and telephone systems. During the last ten years, however, interest rates have risen to all-time high levels. Also during this time, the demand for electric and telephone service in rural areas has been heavier than anticipated, leading to a higher-than-expected demand for loans from the Revolving Fund.

The combined effect of high interest rates and heavy loan requirements has been a threat to the solvency of the Revolving Fund. If electric and telephone systems are to continue to serve rural America--and I believe they must--they will need an adequate and reliable source of capital. H.R. 3050 will help provide that capital by putting the Revolving Fund back on a sound footing.

Cooperative enterprises are a strong and vital part of our nation's economy. For nearly fifty years electric cooperatives have played a major role in the advancement and development of rural America and enhanced agricultural production. Rural electric and telephone cooperatives provide an important, necessary service in sparsely populated and remote regions of the nation, typically serving large geographical areas with few consumers per square mile. Serving these areas is difficult and expensive when compared with serving densely populated urban areas. Because of this expense, passage of H.R. 3050 is essential to the 25 million agricultural and rural-area consumer/members being served by the rural electric cooperatives.

The major goal of the rural electric program is to provide an adequate and reliable supply of electric energy to rural America at the lowest possible cost. After extensive study of alternatives for long-term financing, you have developed legislation which would achieve this goal. I support H.R. 3050, and I urge my colleagues to act promptly and favorably on this bill.

TESTIMONY OF

HONORABLE HAROLD V. HUNTER

ADMINISTRATOR, RURAL ELECTRIFICATION ADMINISTRATION

Mr. Chairman, and members of the committee, I appreciate this opportunity to appear before you today to discuss H.R. 3050, a bill to amend the Rural Electrification Act.

I have mixed emotions about testifying today. On the one hand, I cannot help but feel gratified that Congress and the trade associations have heeded the alarms we have sounded over the past several years concerning the deteriorating financial condition of the Rural Electrification and Telephone Revolving Fund (RETRF). When we first started raising those concerns and suggesting types of actions which would help restore the Fund's health, the reaction we received was "if it ain't broke, don't fix it." Our budget proposals have addressed the concerns by gradually increasing supplemental private financing administratively in order to maintain the fund's solvency and achieve the objectives of the 1973 Rural Electrification Act.

Now, rather than solving a potential problem with an administrative solution, the same people who once dismissed our concerns are seeking major and very costly legislative changes, including the immediate forgiveness of \$7.9 billion worth of debts that do not even begin to come due for another 10 years. For good measure, the proposal asks you to deprive Treasury of uncounted billions of additional dollars in future years through mandating one-way, downward-only refinancing of Certificates of Beneficial Ownership (CBO's) and loan guarantees and requiring that the Secretary of Agriculture request direct appropriations to support discretionary (reduced interest rate) loans. Without these massive additional giveaways, we are told, the long term viability of the Fund and the REA program is threatened.

Back in 1973, when the RETRF was established, we had a clear expression of Congressional intent and a clear consensus as to the purpose and direction of the RETRF. It was not intended that the Fund require substantial subsidies on a regular basis. The new interest rate of 5 percent was close to the then prevailing cost of money to government. Further, Congress explicitly stated that the borrowers were to be helped toward gradual financial and operational independence from REA.

Unfortunately the proposal before us represents a gross overreaction to the Fund's current problems. It represents an attempt to stampede Congress into actions which purport to strengthen the Fund, but which in fact only serve to delay, at great cost to the taxpayer, the Fund's insolvency. It represents an attempt to perpetuate unrealistically low interest rates, thereby increasing borrower reliance on the Federal government. Thus, this proposal represents a virtually total abandonment of the Congressional consensus we had about the direction and future of the Fund back in 1973.

In 1973, the RETRF was established using \$7.9 billion in interest-free loans from the Treasury as seed money. There was never any doubt that these were loans and that they were to be repaid. We are being told that Congress should forgive them now, because their very existence seems to cause anxiety. We are being told that forgiveness of the loans will have no impact on the public debt. Well, if this promissory note signed by one of my predecessors is not a loan, I do not know what it is. If the existence of this loan and others like it cause anxiety, I can prescribe a simple cure: raise RETRF interest rates

enough so that the loans can be repaid. The necessary rates do not have to be exorbitant, either. In fact, they would still be up to a couple percent below the government's own cost of borrowing and still balance the Fund. The \$7.9 billion is real money, money that cannot be made to disappear by erasing a number in one column and writing it down in another, money that the Fund owes to Treasury, and money that will have to be raised by taxes or Treasury borrowing if the long-term notes are forgiven.

In 1973, the standard RETRF rate was raised to 5 percent. This increase was intended to assure that the \$7.9 billion in seed money would grow and would, after the repayment of the \$7.9 billion in loans, continue to provide a source of funding for deserving borrowers at reasonable rates. At the same time, the increase to 5 percent brought the RETRF rate more closely into line with the prevailing cost of money to government. Now, ten years later, much of the financial leverage which that \$7.9 billion interest free loan provided has been used up. But the leverage has not been exhausted. If, for example, RETRF rates were raised to within a couple of percentage points below the government's cost of borrowing, enough revenues would be generated to permit full repayment of the long-term notes, continuing levels of program activity, and absorption of REA's costs for discretionary (reduced interest rate) loan activity. Such an adjustment in rates would assure that the RETRF would be a source of adequate funding support at clearly favorable but not excessively low interest rates. So what does the proposal before us advocate?

Section 6 establishes a formula which would be used to set RETRF interest rates at levels which will yield sufficient interest receipts to pay CBO interest expenses but will not provide for repayment of long-term notes or even CBO principal. As CBO's mature or are paid through amortization, they will be rolled over through the sale of new CBO's. Consequently, the primary financing vehicle of the RETRF will be annual CBO sales of ever increasing size; in effect, not a true revolving fund.

Of course, for those who are not bothered by increased intrusion of the Federal government into the credit markets, this proposed new RETRF structure is not a problem. But the Section 6 formula dynamics have one additional result: the formula will almost assuredly result in RETRF insolvency. Even with forgiveness of the \$7.9 billion, the fund will still go insolvent under program growth and cost of borrowing conditions resembling those of recent years. These conclusions are based on extensive computer modelings of the Fund under the bill's proposals and formula. A description of our methodology and summary of our findings are provided. We would of course be happy to discuss the specifics of our methodology and findings with you, just as we informed the trade associations of our approach and findings back in June. Our analyses demonstrate that the formula fails with equal regularity whether or not CBO's are amortized. Enactment of this bill will put into law a formula which is almost guaranteed to fail.

Speaking of guarantees, the 1973 Act envisioned interest rates on loan guarantees and CBO's which would reflect the rates paid by the Federal government for Treasury borrowings of comparable maturity. Recent high interest rates have resulted in correspondingly high CBO rates, and may result in some high rate loan guarantees. The bill before us provides for penalty-free, one-way, downward-only refinancing of CBO's and loan guarantees. The only types of situations where these provisions do not result in increased cost to government are where the government's cost of borrowing rises to 15 percent and remains there indefinitely. In any case where interest rates follow a downward trend or a more traditional cyclic pattern, the cost to the Treasury of these refinancing provisions will be far greater and more immediate than the forgiveness of the \$7.9 billion in long-term notes.

Another major problem with the proposed legislation relates to changes in REA lien accommodation and subordination policies. Those changes could essentially require REA to subordinate its liens for virtually any reason requested by a borrower. We believe that our primary fiduciary responsibility is to assure the security of loans we make. We also believe that we should not allow our security to be diluted by subordinating or accommodating our lien to support ventures not otherwise fundable under the Act. Another major problem is the requirement that REA guarantee third party (National Rural Utilities Cooperative Finance Corporation (CFC)) debt. This provision will only make cooperatives more reliant on Federal government credit guarantees. Further, since states and municipalities are eligible borrowers, the language in Section 7 of H.R. 3050 could be interpreted to require REA loan guarantees

for tax-exempt obligations such as municipal or state bonds. According to the U.S. Treasury, Congress has enacted 24 statutes which preclude Federal guarantees of tax exempts since 1970. Therefore, we strongly oppose this provision.

Quite frankly, we believe that the framers of the bill did not in all cases realize the true extent of the giveaways and forgivenesses contained in those provisions; the costs of those giveaways and forgivenesses to the government, the taxpayers, and future generations of rural electric and telephone consumers/subscribers; and the extent to which this legislation makes the borrowers look like they are seeking an unwarranted and extremely costly handout.

We believe that when one considers the value of many Federal benefits already provided to the cooperatives (e.g., subsidized direct loans, 100 percent loan guarantees, tax-exempt status, tax-exempt municipal bonds for pollution control equipment, incentives under Safe Harbor Leasing even though most cooperatives have been tax-exempt, and preferential access to low-cost Federal power), the proposal before us represents a major increase that is neither justified nor consistent with the goal of the 1973 Rural Electrification Act calling for greater borrower reliance on private credit. This proposal is an overreaction to a potential future problem with the fund. Therefore, we strongly oppose the legislation.

STATEMENT OF HONORABLE TOM BEVILL
BEFORE THE SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT
OF THE HOUSE AGRICULTURE COMMITTEE
OCTOBER 4, 1983

Mr. Chairman and Members of the Subcommittee, it is a pleasure for me to appear before this most distinguished panel to testify in favor of H. R. 3050.

In my view, this legislation, introduced by my good friend Ed Jones, will make a significant step toward guaranteeing the solvency of the Rural Electric and Telephone Revolving Fund.

I am a strong supporter of continuing the development efforts which REA has brought to rural America. In delivering power and telephone systems to the farmlands and small remote communities across this great land, REA provided the spark which ignited a flurry of economic growth.

And REA continues to provide financing to bring state-of-the-art power and telephone facilities to our rural locales. In fact, hardly a month goes by without a community in my largely rural fourth district of Alabama receiving needed loan monies from REA.

These loans provide the capital to proceed with electrical and telephone development. This development, in turn, brings with it far-ranging economic growth to the community's industrial and agricultural sectors. And rural America stays on the move.

However, there are those within this country who want to see such government-spurred development halted because they believe sufficient development of rural America has already been accomplished. But I am convinced they are using short-sighted economic logic. And short-sightedness does not promote growth, it allows decay.

Those who claim that our government's economic programs over the past 50 years have been ineffective and wasteful don't know their history. They want to instill "economic isolationism" in America between those with money and those without.

HON. TOM BEVILL
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I think it prudent to re-examine the economic conditions the United States was facing during the 1930's, which led to the creation of the REA and other successful programs.

We had just been economically, socially and morally devastated by the worst depression in history. Some of the best farmlands had become a dustbowl. Family fortunes, homes and businesses had vanished in the collapse of banks. Factories were idled, breadlines formed. America was at a low point and millions had lost everything but hope.

But this country did not roll over on its back and die. Instead it began to restore itself. And that restoration, fueled by the hope which has nourished America from its beginning, produced the most dynamic economic boom in history.

The bank collapse led to the formation of a national insurance system to guarantee the solvency of this country's banking system.

The loss of family homes led to the establishment of a federal mortgage protection program insuring the continuation of private home ownership

The dustbowl led to the creation of meaningful assistance to our nation's farmers.

And your Chairman is one who knows first-hand the economic turnaround began 50 years ago in the Tennessee Valley. He has seen the economic, agricultural, flood-control and power development in the Tennessee Valley initiated by government investment through the TVA.

And the Rural Electrification Administration has been at the forefront of America's economic revitalization. As one of the most successful government programs created a half-century ago, REA has helped rural America prosper.

I believe H. R. 3050 is the legislative instrument Congress needs to pass to keep that growth from being halted

As you know, the Rural Electric and Telephone Revolving Fund has been hit hard by the double-digit interest rates of the past few years. While the rates it paid for funds skyrocketed, its capital was eaten into.

HON. TOM BEVILL
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In assessing the future of REA, and the action Congress should take, we have two options. The first would be to turn our backs on the continued development of rural America by increasing rates on REA loans, reducing available borrowing funds and forcing cooperatives to borrow more money from the private lenders. In other words, we can shut the door on future development.

That action could bring economic stagnation to rural America. First, it would probably increase monthly power bills for rural Americans by as much as \$100 a month. And their bills already average 12 percent higher than urban power customers. Further, it would prohibit needed expansion of the power and phone systems serving rural areas.

The second option would be to reaffirm our belief that rural America is a solid investment by implementing the provisions of H. R. 3050.

This legislation would enable periodic adjustments in the interest rate on REA insured loans. This fiscally responsible move would permit sufficient flexibility to cover interest expenses of capital borrowed by the Revolving fund.

The legislation would also convert notes currently due to be paid to the U. S. Treasury beginning in 1993, into permanent equity capital of the revolving fund. These provisions, contained in this legislation would create the basis for a self-sufficient fund to assure the continued availability of capital for future development.

No one would be released from paying the full amount due on REA loans in force today. No one would be released from paying the full amount due on future REA loans. The purpose of this legislation is not to forgive any debt. The purpose is to secure long-term solvency to this important economic development fund.

Rural power and telephone development has constraints imposed on it which urban development does not. The sparsely settled nature of rural areas carries with it a tremendous investment per household. Expecting rural citizens to absorb the full brunt of this expense is not logical.

HON. TOM BEVILL
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These people have suffered severely in recent years from downturns in farming. Poor crops, bad weather, high expenses, low market prices and high interest rates have combined to deal a devastating blow to our farmers, agribusinesses and rural communities. We cannot in good judgement expect them to shoulder yet another burden.

H. R. 3050 holds hope for again bringing progress to our rural communities. I totally support this legislation and I will work for the continued development it provides to rural America.



POWER AND COMMUNICATION CONTRACTORS ASSOCIATION

700 Seventh Street, S.W. Suite 3 Washington, D.C. 20024 202-484-8100

STATEMENT OF THE
POWER AND COMMUNICATION CONTRACTORS ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT
OF THE
HOUSE COMMITTEE ON AGRICULTURE

October 4, 1983

by

Mr. Lee W. Hogan

Director and Legislative Committee Chairman

Mr. Chairman and Distinguished Committee Members:

My name is Lee Hogan. I am owner and President of Universal Electric Construction Company, Houston, Texas. I appear today on behalf of the Power and Communication Contractors Association as a member of the Association's Board of Directors, and Chairman of its Legislative Committee. The Power and Communication Contractors Association represents a highly specialized, little publicized, segment of the National Construction Industry. Nevertheless, our organization includes 268 corporate members; employs 25,000+ American workers; completes \$925,000,000 of construction annually; and, for the past two decades, we have constructed more

than 75% of the REA and RTA projects completed in this country.

We want to make it abundantly clear at the onset of this testimony, that we have a direct financial interest in the REA construction program and our testimony is thus prejudiced. However, we feel strongly that our experience with REA since its inception in 1936 gives us a perspective that we can beneficially share with your Committee in the consideration of HR 3050.

This legislation, and its companion S1300, present the U.S. Congress with its second opportunity to restructure the REA program in the past decade --- the first being the creation of the revolving fund in 1973. You are now facing three choices:

- (1) Abandon the REA program and require member electric and telephone coops. to repay the revolving fund corpus beginning in 1993 and to finance future construction through private financial sources.
- (2) Dissolve the revolving fund and revert to a system of funding REA requirements through annual budget appropriations.
- (3) Adopt the modifications to the revolving fund proposed by both NRECA and NTCA as embodied in HR 3050.

Although there are clearly variations and permutations on these three options, this delineation accurately identifies the three philosophical approaches available to you.

Our organization strongly supports Option 3 --- HR 3050 --- for the following reasons:

- (1) The retention of the revolving fund, with rates adjusted to match the cost of borrowing by the fund, will provide a permanent method of funding that will neither increase Federal deficits nor exert upward pressure on interest rates, since the projects involved will be built in either the private or public sector under any of the three options considered.

- (2) Environmental, engineering, and easement considerations now mean that virtually all electric and telephone projects require two to four years from inception to completion. Such programs are clearly not appropriate for annual budget appropriations that may vary wildly with changes in the economic and political climate.
- (3) The standardization of engineering and contractual requirements by the REA has provided, and will continue to provide, lower construction costs to the REA's and RTA's of the Nation. Our Association, which does work for investor owned electric and telephone utilities, municipal systems, and other governmental agencies (Defense Department, Corps. of Engineers, and various power authorities), has completed studies showing REA bids average 5-12% below other categories because of REA's superior standards. These savings translate directly into lower utility bills for cooperative members.

Our Association has noted with concern the criticism directed at the REA program by the U.S.D.A. Inspector General's office as referred to in the WALL STREET JOURNAL of 9/1/83. Although we would refute most of the conclusions in Audit Report #09613-1-Ch, as transmitted to Administrator Hunter by Mr. D. E. Adkisson on May 20, 1983, we have particular expertise relating to Recommendation #5, Section II, Page 4 of that report. Mr. Adkisson's suggestion that only those construction projects anticipated in work plans submitted two years prior to need should be reimbursable with loan funds demonstrates such an appalling ignorance of the functioning of a utility system that it completely destroys the credibility of the entire report. This suggestion totally ignores the inequitable occurrence of national disasters, mineral exploration booms, rapidly conceived industrial loads, and changing growth patterns that simply cannot wait the six to eight months necessary for receiving approval for modified work plans. Fortunately, the men and women of

the REA program and member coops. have exercised better judgement in providing rural utility service to this country for the past 50 years than the Inspector General did in preparing his report.

In summary, Ladies and Gentlemen of the Congress, HR 3050 provides you with the opportunity to continue one of the most successful and efficient Federal programs for the last half century, at no cost to the Federal budget, by adopting modifications to the current system which the rural electric and telephone industry has thoughtfully developed prior to the arrival of a crisis. We hope you will share our support of this desirable legislative solution.

TESTIMONY OF

DAVID C. FULLARTON

on Behalf of the
NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

Before a Hearing of the
House Agriculture Subcommittee on
Conservation, Credit and Rural Development

October 4, 1983

SUMMARY

The 435 member systems of the National Telephone Cooperative Association, which provide telephone service to five million consumers in the most rural areas of 42 states, support in the strongest terms the passage of H.R. 3050. The legislation parallels recommendations of the NTCA Future Financing Committee. The committee was assisted in its deliberations by Joseph Vellone, who among other things, provided assistance in drafting the legislation creating the telephone revolving fund in 1973, and who, until joining NTCA in 1982, worked at REA, where he had most recently served as Acting Assistant Administrator for Administration, and Assistant Secretary of the Rural Telephone Bank. NTCA is anxious to assist REA to begin changing with the times.

Although fully 95 percent of rural Americans today have access to telephones, it is still infeasible for small telephone systems serving high cost rural areas to provide service at commercial interest rates.

Some problems faced by REA telephone borrowers today include:

- o The entire telecommunications industry is in the midst of an unprecedented upheaval. The long-standing commitment to universal telephone service is in danger, due to sweeping changes in the regulation of the industry. Recent FCC and court decisions would allow telephone companies to provide services and equipment on a deregulated basis, but at the same time, these decisions would erode the traditional sources of small company revenue. The FCC access charge scheme would add yet another burden to rural residents; one causing rural rates to spiral within a matter of a few short years. In short, the continued viability of rural telephone service will be critical to maintaining the national network.
- o Most small, rural telephone systems are still unable to qualify for commercial financing, owing to their low debt:equity ratios, which averaged 26.3 percent of total assets at the end of 1982.
- o Current REA policies deny borrowers access to outside financing. REA holds a first lien on all property owned or subsequently acquired by the borrower. REA, in addition, has generally refused to share this lien with private lenders who would otherwise be willing to provide financing, unless the borrower agrees to provide a "compensating benefit" to the government, which often means reducing the term on the existing notes, or pre-paying one or more of the notes. This policy makes it difficult, if not impossible for borrowers to secure

commercial financing, which, in turn would actually enhance the government's loan security.

- o There exists an increasing strain on the ability of the revolving fund to meet the capital requirements of rural telephone companies, due to inflation and high interest costs. The disparity between the amount REA must pay for funds and the interest rate it receives on loans to telephone system borrowers has created a growing imbalance in the revolving fund, whose interest costs, by 1986, are expected to exceed its interest receipts from borrowers.

H.R. 3050 provides the following solutions:

- o H.R. 3050 would ensure the continued financial health of the REA telephone program: by authorizing the REA administrator to adjust periodically the standard interest rates on new REA loans to the level required to ensure that the revolving fund's interest expenses are recouped; and by exchanging \$7.9 billion in notes payable by REA between 1993 and 2016 for an equity interest in the revolving fund, thereby strengthening the fund for the future. Without this latter provision, interest subsidies of more than \$30 billion -- almost four times the amount of notes involved -- would be required within the same time frame. The first of such subsidies, authorized under current law, is included in the 1984 appropriations bill, approved by both Houses of Congress.
- o H.R. 3050 would help borrowers diversify their operations and secure private market financing. One provision would direct the REA Administrator to subordinate or accommodate its liens at the request of the borrower.

The administration has suggested restoring the balance in the revolving fund by cutting the amount of available loan funds and raising interest rates in an attempt to force borrowers onto a commercial market that will not lend them money. Without the lien accommodations and other administrative policy changes detailed in H.R. 3050, borrowers would simply be shut off from the commercial market.

H.R. 3050 should be viewed as a comprehensive, forward-thinking package, designed to bring the REA telephone and electric programs into the eighties and beyond. The solutions proposed to existing problems in H.R. 3050 are sound and timely. Without this legislation, continuation of rural telephone service -- and therefore universal service -- would be jeopardized. H.R. 3050 addresses current problems with workable solutions today, before a massive federal bailout is called for in the future.

It is time, once again, for REA to change with the times.

Mr. Chairman and Members of the subcommittee. My name is David C. Fullarton. I am the Executive Vice President of the National Telephone Cooperative Association (NTCA). NTCA is a national trade association made up of 435 locally owned and operated small telephone systems providing service to five million consumers in the most rural areas of 42 states.

I appreciate the opportunity to appear before you today to discuss the need for changes in the Rural Electrification Administration (REA) loan programs. Our long-standing support for the REA telephone program spans almost three decades. When our association was formed in 1954, the telephone loan program was still in its infancy. We have grown together and relied upon one another and have changed, accordingly, as times have changed.

That is what is at the heart of this legislation: the ability of REA to change as times warrant. NTCA supports H.R. 3050 in the strongest possible terms. The basis for that support comes from our members' years of experience in delivering high caliber telephone service to rural Americans. Allow me to provide a framework of reasons why NTCA believes the time has come to pass H.R. 3050. I will define the problems we have experienced, and outline solutions incorporated into the legislation. Let me say at the outset that this legislation parallels the recommendations of some of the finest minds in rural telephony: our members of the NTCA Future Financing Committee, who spent many weeks researching and exploring alternatives in reaching solutions to these problems with the help of Joseph Vellone who is seated beside me today.

Mr. Vellone is NTCA's Special Counsel. He joined our staff in 1982 with the primary responsibility of helping our members explore the various sources of financing for their diversified operations and to prepare for industry changes brought on by competition and deregulation. He came to NTCA directly from REA where he had been serving as Acting Assistant Administrator for Administration and Assistant Secretary of the Rural Telephone Bank. In these positions, he directed and coordinated the general administrative activities of six separate divisions within REA. Mr. Vellone also provided technical assistance to the House Committee on Agriculture in drafting the legislation which eventually created the telephone revolving fund in 1973. I cannot imagine an individual better qualified to address your comments, as he will following my statement.

As many of you are aware, the REA telephone loan program was created by Congress in 1949, when fully 62 percent of rural areas were without telephones. What little service there was, was provided on inadequate multi-party lines. The telephone loan program came into being because it was not feasible to serve most underpopulated areas, where capital costs are higher and customers are sparse, at interest rates required by most lenders.

Today, though 95 percent (REA figures) of rural Americans have access to telephone service, it is still not feasible for the small telephone systems serving high cost rural areas to provide that service at commercial interest rates.

But the REA program stepped in to fill a vital need. It offered rural telephone companies low interest loans in exchange for a commitment from each borrower to extend service to the largest practical number of subscribers, regardless of profitability. Recognizing the need for technical assistance, REA also established standards specifically for the design of rural telephone systems; equipment specifications, engineering designs and construction techniques. Within ten years, REA assistance had extended service to subscribers in 45 states through 700 telephone companies.

The success of the program was borne out by the fact that by 1971 the need for growth capital had far surpassed the availability of funds in the telephone loan program. As a result, REA changed with the times. The Rural Telephone Bank (RTB) was created by Congress as a means of providing supplemental financing at higher, closer-to-market interest rates. The establishment of the RTB served two important functions: it allowed companies which could feasibly pay the higher interest rate to provide their customers with better quality service, while it relieved some of the pressure on the lower interest REA insured loan program.

Another important change came in 1973, when Congress established the Rural Electrification and Telephone Revolving Fund as the new source for REA loans. This followed on the heels of Administration impoundment of funds that had already been appropriated by Congress. Initial assets of the fund included outstanding notes of REA borrowers and undisbursed balances of previously approved REA loans. Its liabilities included \$7.9 billion in non-interest bearing REA notes to the Treasury. The revolving fund is replenished through collections on outstanding and future REA loans, interim Treasury borrowings, and money from the sale of Certificates of Beneficial Ownership (CBOs), which represent pools of borrower notes that REA holds on its loans.

The REA telephone loan program has been an unqualified success. Not one loan has been lost through foreclosure. The program has been instrumental in developing and maintaining the nation's universal telephone network. It has made modern, affordable telephone service possible for upwards of 11 million rural Americans. In no small measure, the success of the program has rested on its ability to adapt in changing times.

Today is one of those times.

The Problem

REA telephone program borrowers still face high capital costs distributed among fewer customers than do urban systems. But today this problem is just one among many confounding rural telephone companies, and the picture is critical.

The telecommunications industry is in the midst of a tremendous upheaval. The long-standing national commitment to universal telephone service is precarious, at best, due to sweeping changes in the way the industry is regulated. While recent Federal Communications Commission (FCC) and court decisions would allow telephone companies to provide services and equipment on a deregulated basis, these same decisions would cause the erosion of traditional sources of small company revenue, such as payments to the local system for long distance services. The access charge scheme promulgated by the FCC would add yet another burden to residents of rural areas; a burden which, down the road, will contribute to spiralling rural rates.

The continued viability of telephone service for rural people will be a critical element in maintaining the national network. Now is the time to face the challenge: to equip REA to help rural telephone systems better grapple with these problems. To survive in the competitive environment mandated by the FCC, rural telephone companies must develop financial strength through diversification with new services and operations that will provide new sources of revenue to support the necessarily high costs of local rural service.

Two roadblocks stand in our way. First, most small, rural telephone systems, with their low equity ratios, still cannot qualify for financing on the commercial market. The average net worth of all REA telephone borrowers at the end of 1982 was only 26.3 percent of total assets. Clearly, most small, rural telephone systems will require continued government financing to supply high-cost local telephone service for the foreseeable future.

Secondly, current REA policies deny borrowers access to other sources for financing which is not available under programs administered by REA. The agency holds a first lien on all property owned or subsequently acquired by the borrower, regardless of whether the funds to purchase the property were provided by REA or another lender. In addition, REA has generally refused to share its lien with private lenders willing to fund projects which REA is not now financing, unless the borrower agrees to provide a "compensating benefit" to the government. REA often narrowly defines that term to mean reducing the term of existing REA notes, or in some cases, prepaying one or more of the notes. In most cases, this is simply not practical.

Since most private lenders require a first mortgage position on new projects or a favorable common mortgage covering existing and new plant, current REA policy makes it difficult -- if not impossible -- for borrowers to secure financing for worthy projects that could strengthen their overall financial stability and actually enhance the government's loan security.

In addition, REA's policy on the use of general funds often works to prevent borrowers from investing their own funds in new plant that could help ensure long-term viability in the face of increasing competition within the local exchange area. The current general funds policy requires a telephone system to maintain its general funds (REA considers money spent in prior years directly or indirectly for "miscellaneous physical property" as still available to reduce the amount of the next loan or loan advance) at a level below eight percent of its total telephone plant investment, if the borrower wants to continue receiving new loans or advances on existing loans.

REA recently took steps to diffuse this issue by proposing to allow borrowers who can pay dividends or retire capital credits without prior REA approval to invest the amount of the allowable distribution instead in new telecommunications projects, without having it count in the general funds calculation. However, any services not classified as telephone service under the existing definition would have to be provided through a separate subsidiary.

This proposal would offer little relief. Few borrowers can make distributions without REA approval in an amount large enough to provide a subsidiary with an equity base that would attract private capital. In fact, some telephone cooperatives could encounter legal restrictions or adverse tax effects by investing in a subsidiary. Again, the problem is exacerbated by the fact that REA steadfastly refuses to share its mortgage security with other lenders.

NTCA has raised these issues time and again with the administration, most recently in comments on the current REA general funds proposal which was submitted in August, but to no avail.

Along with administration policies that preclude commercial lending to rural telephone systems, there is increasing strain on the ability of the revolving fund to meet the capital requirements of rural telephone companies. Inflation and high interest costs have combined to take a toll on the fund over the past decade. Borrower repayments meet only part of the demand for new loan funds and interest payments on the funds obligations, primarily CBOs with interest rates between 10 and 15 percent. The disparity between the rates REA must pay for funds and the five percent rate it receives on loans to telephone systems has created a growing imbalance in the revolving fund. By 1986, the

fund's interest costs are expected to exceed its interest receipts from borrowers.

These problems are serious, but not insurmountable. NTCA has been working with other associations to draw up recommendations for solving these problems; to provide a framework to help REA once again change with the times. Many of the recommendations are found in H R 3050. This legislation would ensure the continued financial health of the REA telephone program in two major ways. First, it would authorize the REA administrator to adjust the standard interest rates on new REA loans periodically to the level required to ensure that the revolving fund's interest expenses are recouped. (At the same time a discretionary loan program would provide loans to systems experiencing financial hardship at a rate somewhere between two percent and half the standard rate.)

Second, the legislation would exchange \$7.9 billion in notes payable by REA between 1993 and 2016 for an equity interest in the revolving fund. Contrary to contentions on the part of the Administration, there is no "forgiveness" of debt involved. In effect, the government would be providing equity capital instead of debt capital to strengthen the revolving fund. This is the same procedure used by many corporations in issuing stock for convertible bonds. Without this provision, the revolving fund would have to borrow even more to remain viable, largely offsetting any advantage to the Treasury from retiring the notes. In addition, the change would involve no government appropriations. Without it, interest subsidies of more than \$30 billion--almost four times the amount of the notes involved -- would be required between 1993 and 2016. The first of such subsidies, authorized under current law is included in the 1984 appropriations bill, approved by both the House and the Senate.

The proposed legislation contains several provisions that would help borrowers diversify their operations and secure private market financing. The most important of these would direct the REA Administrator to subordinate or accommodate its liens at the request of the borrower reflecting a positive step in adapting to a changing telecommunications environment. As new supplemental sources of financing have developed, an unfortunate conflict has arisen between the Administration's desire to reduce borrowers reliance on REA and its simultaneous refusal to share its security interests in borrower assets with other lenders. The provision would require lien accommodation, upon a finding that the borrower can repay its debt, for any purpose that would enhance financial strength or revenue. This expanded authority would encourage other lenders to provide loan funds that are not available through REA or the Rural Telephone Bank.

The Administration has suggested restoring the balance in the revolving fund by cutting the amount of available loan funds

RURAL ELECTRIFICATION ACT AMENDMENTS

The National Telephone Cooperative Association (NTCA) and its member systems throughout Rural America are grateful to this committee for holding hearings on legislation required to make the Rural Electrification Act more responsive to the needs of Rural America. NTCA Executive Vice President David C. Fullarton has presented, in his remarks and in his prepared statement, the need for such legislation in a changing environment. I will discuss the various sections of H.R. 3050, the "Rural Electrification and Telephone Self Sufficiency Act of 1983," and give the reasons these proposed amendments merit your support.

A. REA Telephone Loan ProvisionsSec. 2. Eliminating Nonduplication Finding for REA Telephone Loans

Sec. 2 of H.R. 3050 amends sec. 201 of the Rural Electrification Act by striking from the next to the last sentence the requirements that no telephone loan shall be made in any state with a State regulatory body having authority to regulate telephone service and to require the loan applicant to obtain a certificate of convenience and necessity unless such certificate is first obtained. The requirement in the present Act is superfluous as sec. 202 provides that "Nothing contained in this Act shall be construed to deprive any State commission, board, or other agency of jurisdiction, under any State law, now or hereafter effective, to regulate telephone service which is not subject to regulation by the Federal Communications Commission, under the Communications Act of 1934, including the rates for such service."

Sec. 2 also strikes the last sentence in sec. 201. This is necessary to eliminate the present requirement that no loan shall be made in a state which has no regulatory body authorized to issue certificates to the applicant unless the Administrator determines that no duplication of lines, facilities, or systems, providing reasonably adequate services will result therefrom.

Since 1949, when this provision was added to the Act, the Administrator has been required to make a nonduplication finding before making a loan only in states where the regulatory body did not require the applicant to obtain a certificate authorizing the proposed construction. A certificate, however, is not necessarily a guarantee of "nonduplication," and in today's competitive environment, nonexclusive certificates should become very common. The present law, however, makes it difficult for REA to finance competitive facilities in a state where there is no state regulatory body with certificate jurisdiction over the borrower. This could result in small telephone systems being denied financing for an interconnection with more than one long-distance carrier, if the nonduplication finding requirement is not eliminated. Elimination of the requirement would help borrowers in such states or territories as:

TESTIMONY OF

JOSEPH VELLONE

on behalf of the
NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

Before a Hearing of the
House Agriculture Subcommittee on
Conservation, Credit and Rural Development

October 4, 1983

RURAL ELECTRIFICATION ACT AMENDMENTS

The National Telephone Cooperative Association (NTCA) and its member systems throughout Rural America are grateful to this committee for holding hearings on legislation required to make the Rural Electrification Act more responsive to the needs of Rural America. NTCA Executive Vice President David C. Fullarton has presented, in his remarks and in his prepared statement, the need for such legislation in a changing environment. I will discuss the various sections of H.R. 3050, the "Rural Electrification and Telephone Self Sufficiency Act of 1983," and give the reasons these proposed amendments merit your support.

A. REA Telephone Loan Provisions

Sec. 2. Eliminating Nonduplication Finding for REA Telephone Loans

Sec. 2 of H.R. 3050 amends sec. 201 of the Rural Electrification Act by striking from the next to the last sentence the requirements that no telephone loan shall be made in any state with a State regulatory body having authority to regulate telephone service and to require the loan applicant to obtain a certificate of convenience and necessity unless such certificate is first obtained. The requirement in the present Act is superfluous as sec. 202 provides that "Nothing contained in this Act shall be construed to deprive any State commission, board, or other agency of jurisdiction, under any State law, now or hereafter effective, to regulate telephone service which is not subject to regulation by the Federal Communications Commission, under the Communications Act of 1934, including the rates for such service."

Sec. 2 also strikes the last sentence in sec. 201. This is necessary to eliminate the present requirement that no loan shall be made in a state which has no regulatory body authorized to issue certificates to the applicant unless the Administrator determines that no duplication of lines, facilities, or systems, providing reasonably adequate services will result therefrom.

Since 1949, when this provision was added to the Act, the Administrator has been required to make a nonduplication finding before making a loan only in states where the regulatory body did not require the applicant to obtain a certificate authorizing the proposed construction. A certificate, however, is not necessarily a guarantee of "nonduplication," and in today's competitive environment, nonexclusive certificates should become very common. The present law, however, makes it difficult for REA to finance competitive facilities in a state where there is no state regulatory body with certificate jurisdiction over the borrower. This could result in small telephone systems being denied financing for an interconnection with more than one long-distance carrier, if the nonduplication finding requirement is not eliminated. Elimination of the requirement would help borrowers in such states or territories as:

California	Montana	Ohio
Guam	Nebraska	Oregon
Maine	New Hampshire	Puerto Rico
Maryland	New Jersey	Vermont
Massachusetts	North Carolina (Coops)	Washington

Sec. 3. Revising Definition of Telephone Service and Rural Areas
for Telephone Loan Purposes

Sec. 3 amends sec. 203(a) to clarify the definition of telephone service. This is desirable to reflect changes in technology. Transmission of data, which is a growing operation of all telephone systems, is specifically mentioned, as well as transmission by wire, fiber, radio, light, or other visual or electromagnetic means. Message telephone service, community antenna television service not intended exclusively for educational purposes, and radio broadcasting, however, continue to be excluded from the definition.

Sec. 3 also amends sec. 203(b) to modify the definition of rural area to include towns with populations of 2,500 or less. This is more realistic than the limit of 1,500 established in 1949. The change is considered necessary to facilitate transfers of territory to improve the operating efficiency and even the viability and loan security of the systems involved in the new deregulated competitive arena.

B. REA Electric and Telephone Loan Provisions

Sec. 4(1). Increasing Revolving Fund's Equity Capital

Sec. 4(1) amends sec. 302 to provide that the notes of the Administrator to the Secretary of the Treasury to obtain funds for loans under sections 4, 5 and 201 of this Act "shall be equity capital of the fund" instead of "liabilities of the fund."

This amendment will strengthen the revolving fund by exchanging REA's notes to the Treasury for equity interests in the fund, thus reducing the need for new borrowings or sales of certificates of beneficial ownership to keep the fund viable. To understand the operations of the revolving fund, it is necessary to review the fund's origin and the model on which it was based.

On December 29, 1972, the Department of Agriculture announced in a two page press release the termination of REA's direct loan programs and the impoundment of \$456 million of unobligated funds appropriated by the Congress. The press release stated that "Beginning on Jan. 1, 1973, all REA loans will be made as guaranteed and insured loans under the authority of Section 104 of the Rural Development Act of 1972 (Section 306(a)(1) of the Consolidated Farm and Home Development Act)."

This Committee's report on the 1973 amendments to the Rural Electrification Act made it clear that "The Rural Development Act was not designed for that purpose and was never intended by the Congress to be used in such fashion. The 'Rural Development Insurance Fund' should be utilized for only those purposes which are clearly enunciated in the Rural Development Act."

To resolve the conflict between the executive and legislative branches, this Committee then proceeded to develop amendments to the Rural Electrification Act providing for a "Rural Electrification and Telephone Revolving Fund" patterned after the "Rural Development Insurance Fund" but without the restrictions in the Rural Development Act which this committee considered to be inappropriate for rural electric and telephone systems.

These amendments became law on May 11, 1973. To establish REA's revolving fund, the 1973 amendments transferred to it all of the following assets:

Outstanding notes payable by electric and telephone borrowers to REA	\$6,598,683,958
Undisbursed balances of electric and telephone loans	882,132,617
All collections of principal and interest from borrowers after June 30, 1972	261,964,343
Other assets, including "all appropriations for interest subsidies and losses which may hereafter be made by the Congress"	<u>60,000,000</u>
Total assets	<u>\$7,802,780,918</u>

The law made the revolving fund liable for \$7,408,638,673 of notes issued by REA to the U.S. Treasury from August 14, 1953, through March 19, 1973, for amounts borrowed to make advances on 2 percent loans to borrowers. With assets of \$7.8 billion and liabilities of \$7.4 billion, REA's revolving fund was started with a net worth or equity investment by the Government of \$0.4 billion or only 5 percent of its assets. Although the 1973 amendments made these notes payable by REA on the original maturity dates, ranging from June 30, 1993, through December 31, 2012, they were made payable without interest.

In 1974 and 1976, REA issued two additional notes which are also liabilities of the fund. They cover amounts used to settle the Sioux Valley case (504 F. 2d 168) and amounts previously impounded. Long term notes payable by REA to the Treasury total \$7,864,742,067.68, attributable to the electric and telephone programs as follows:

Electric	\$6,028,195,224.03	76.6 percent	76.65
Telephone	<u>1,836,546,843.65</u>	<u>23.4 percent</u>	23.35
Total	\$7,864,742,067.68	100.0 percent	

All collections of principal and interest on loans made to REA borrowers become assets of the fund and are used to make advances to borrowers and pay interest on the fund's obligations. These collections, supplemented by undisbursed balances of notes to the Treasury, were sufficient to cover advances to borrowers through fiscal year 1975. Starting in fiscal year 1976, however, certificates of beneficial ownership (CBOs) were issued to the Federal

Financing Bank at interest costs ranging from 8.1 percent to 15.3 percent to meet cash needs of the fund in excess of collections on outstanding loans. CBOs issued through August 31, 1983, totaling \$3,310,707,000, carry an average interest rate of 11.384 percent.

A CBO evidences the sale of some of the borrower's notes in the revolving fund's inventory of notes under a trust agreement whereby the revolving fund promises (a) to pay interest to the purchaser of the CBO at a stipulated rate greater than the interest rate specified in the borrower's notes to REA, and (b) to repurchase the CBO at its maturity date. This is not an unusual arrangement. Farmer's Home and other agencies do this and obtain an appropriation every year to cover the difference between interest received and interest paid. Although the 1973 law authorized Congress to make appropriations for interest subsidies and losses to keep the revolving fund viable, the 1984 appropriation bill, approved by both the House and Senate, is the first one containing appropriations for these purposes.

House Report No. 98-231 (98th Congress, 1st Session), June 3, 1983 on the "Agriculture, Rural Development, and Related Agencies Appropriations Bill, 1984" states, at page 73:

REIMBURSEMENT FOR LOSSES

1983 appropriation.....
1984 budget estimate.....
Recommended in the bill.....	\$197,862,000
Comparison:	
1983 appropriation.....	+197,862,000
1984 budget estimate.....	+197,862,000

This appropriation is to reimburse the Rural Electrification and Telephone Revolving Fund for the differential between interest income and interest costs. The amount recommended by the Committee represents interest costs less the imputed interest associated with loans transferred into the fund when it was established on May 11, 1973.

The Committee feels that the Rural Electrification and Telephone Revolving Fund should be treated the same as the other revolving funds of USDA. Unlike the other revolving funds, there has never been an appropriation to this Fund. In fiscal year 1984, the appropriation for interest and other losses of the other funds are as follows:

Rural Housing Insurance Fund.....	\$1,508,082,000
Agricultural Credit Insurance Fund.....	895,522,000
Rural Development Insurance Fund.....	477,829,000
Rural Communication Development Fund.....	375,000

Rather than allow the Fund to continue to deplete its assets, the Committee recommends an appropriation of \$197,862,000 to restore the Fund to a sound financial basis. This appropriation is budget authority only and has no impact on outlays.

The purpose of this little history is to make it clear that if no action is taken to amend the law at this time to balance the revolving fund by authorizing periodic adjustments of interest rates, as recommended by NTCA and others, the amount of appropriations needed for interest subsidies authorized by the present law will greatly exceed the amount of non-interest bearing notes proposed to be exchanged for equity interests in the fund. Under present law, these notes are scheduled to become payable by REA's revolving fund starting ten years from now and continuing through the year 2016. Charts prepared by REA (See Exhibit 1) indicate that appropriations for such subsidies are expected to total some \$30 billion dollars in the same 1993-2016 period -- almost four times the amount of REA notes payable to the Treasury, without interest, in the same period.

In supporting H.R. 3050, members of NTCA and other associations understand that the bill, if enacted, will make the present standard interest rate for loans from the revolving fund a floor instead of a ceiling in order to cover the interest expenses on the fund's obligations. They will be paying these interest rates (which can easily be four times the interest rates they were paying at the end of 1972 and 33 percent higher than the rate they were paying at the end of 1982) for almost ten years before the first of REA's non-interest bearing notes to the Treasury becomes due in 1993. Cash to pay these notes as they mature will be available only if (a) appropriations are made to cover interest subsidies and losses, or (b) borrowings or sales of CBOs are increased. These are alternatives authorized under the present law. Any of these alternatives would have the effect of offsetting any reduction in the size of the national debt that the Administration anticipates would result from the payment of the notes as originally scheduled.

If the funds to retire these notes are obtained from borrowings or sales of CBOs, the interest costs of these additional CBOs would be reflected immediately in increased interest rates on new loans. Because the amount of notes maturing each year from 1993 through 2016 varies considerably, the interest rate required on new loans would fluctuate greatly from year to year. It is reasonable, therefore, for borrowers to expect, in return for accepting immediate increases in interest rates on their new loans, some protection from the drastic increases that could be required to refinance notes not reaching maturity in less than 10 to 33 years from now.

Exchanging these non-interest bearing notes for an increased proprietorship or equity interest in the fund, similar to the exchange of convertible bonds for stocks in corporate enterprises, will strengthen the revolving fund. It will benefit the REA borrowers and the rural people they serve without adding to the national debt. In fact, enactment of this legislative package will save the Treasury billions of dollars by minimizing, or making unnecessary, the need for appropriations to cover interest subsidies or losses, authorized under present law and routinely approved each year for other revolving funds.

Sec. 4(2). Requiring Payments on CBOs

Sec. 4(2) amends clause (2) of sec. 302(b) to conform it with the proposed amendment to sec. 302(a) making the REA notes equity instead of debt capital, and to specifically provide for the payment of principal and interest on the CBOs.

Believe it or not, sec. 302(b) states the the "assets of the fund shall be available only for the following purposes" and the repayment of principal and interest on CBOs is not included in the purposes listed!

Sec. 4(3). Providing Separate Electric and Telephone Accounts in the Fund

Sec. 4(3) adds a new subsection (c) to sec. 302 to provide for two separate accounts within the fund, one for the electric and one for the telephone program. Each account will include the assets, liabilities, income and expenses pertaining to the particular program.

In the recent past, the Administration recommended a zero loan level for the telephone program. Realizing that collections from the telephone program would be used to make advances on electric loans compounded the unhappiness of the telephone systems. Although there have been no losses in the telephone program and only minimal losses in the electric program (many years ago), problems in both programs could result in some losses in the future. This amendment would assure that collections from each program would be used only in that program and not diverted to provide loans or cover losses in the other.

Sec. 5. Authorizing Repurchase of CBOs Without Penalty

Sec. 5 adds a new sentence at the end of sec. 304(c) authorizing the Administrator to repurchase outstanding CBOs without penalty when their interest rate exceeds the current rate on new CBOs by one full percentage point or more.

CBOs have been issued so far only to the Federal Financing Bank. Although that agency has been borrowing short term to obtain the cash for these long term obligations, its formula for determining the amount needed to repay a CBO generally results in a penalty which discourages any such prepayments.

The ability to make these prepayments could result in substantial savings in interest costs for the revolving fund and the rural people served by its borrowers.

Since CBOs may be issued to purchasers other than the Federal Financing Bank in the future, this proposed amendment might affect the marketability of CBOs in such cases. It is therefore recommended that the amendment be further amended by inserting, after the words "under this subsection" the following words "by another entity in the Federal Government."

Sec. 6(1). Authorizing Adjustments of Interest Rates

Sec. 6(1) amends sec. 305(b) to direct the Administrator to set and periodically adjust the standard rate of interest for new loans made from the electric account and the standard rate of interest for new loans made from the telephone account, in the revolving fund, to make each of them sufficient to cover the interest expenses of the respective account; and to authorize special rate loans for borrowers that meet specified criteria and are experiencing financial hardship.

As set forth in the discussion of the advantages to the Treasury in enacting sec. 4(1), adjusting the standard interest rate from time to time on loans from the revolving fund will result in saving billions of dollars for the Treasury as it will minimize, or make unnecessary, the need for appropriations, presently authorized, for interest subsidies and losses. Rural electric and telephone systems are willing to pay the higher interest rates needed to keep the interest income and expenses of their respective revolving fund accounts in balance if they can obtain, in the same legislative package, other improvements in the programs administered by REA.

Sec. 6(2). Removing Requirement for Expediting Sales of Insured Notes

Sec. 6(2) redesignates subsection 305(c) as subsection 305(d) and eliminates the requirement that revolving fund "loans shall be sold and insured by the Administrator without undue delay."

The present requirement is difficult to administer for construction programs that require advances of loan funds as construction progresses over periods as long as five years. Loans, or certificates of beneficial ownership therein, should be sold only as needed to meet the fund's cash requirements. Hasty sales could provide the fund with cash at times when it is not needed. This would add to the spread between the fund's interest income and expenses as the fund has to pay market, or higher, rates of interest to the holders of insured notes or certificates.

Sec. 6(3). Requiring Budget Request to Replenish Fund for Cost of Special Rate Loans

Sec. 6(3) inserts a new subsection 305(c) requiring the Secretary of Agriculture to request appropriations to cover the costs of special rate loans.

This subsection has been criticized by the Administration "as a step backward" in the financing of REA programs. This criticism is unfounded as it overlooks that fact that the present law authorizes "appropriations for interest subsidies and losses" on all revolving fund loans -- not just the special rate loans. The number of special rate loans under the proposed criteria is not expected to be much higher than the number of special rate loans under the present law.

Secs. 7(1) and (2). Expanding Lien Accommodation Authority

Secs. 7(1) and (2) amend sec. 306 by redesignating it as subsection 306(a) and specifically requiring the Administrator to accommodate and subordinate liens or mortgages at the request of the borrower to enable it to obtain credit from other lenders for any purpose that would improve the "efficiency, effectiveness, or financial stability of the borrower, upon a finding that the borrower has, or will have, the ability to repay its existing and proposed indebtedness." The amendments would include "refinancing" specifically as a purpose for guaranteeing loans and make "any lender approved by the Administrator" eligible for loan guarantee.

REA has adopted questionable policies curtailing the use of REA and Telephone Bank funds for purposes which have traditionally been financed by loans from such sources. Borrowers wishing to borrow funds for these purposes from another lender find that getting REA to share its mortgage lien on satisfactory terms with another lender is a real problem and involves extended delays. REA has an "after acquired clause" in its mortgage which states that REA's lien extends to all of the borrower's property owned or subsequently acquired by the borrower even if the funds for the property were not provided by REA or the Telephone Bank. This clause is being used by REA as leverage to improve its security position by limiting mortgage controls available to the other lender. This is counter-productive as it discourages other lenders from offering credit to REA borrowers.

If the purpose to be financed by the other lender is a purpose which REA claims it cannot itself finance under the Rural Electrification Act, the problem intensifies. In such cases, REA generally demands a "compensating benefit" for sharing its lien with the other lender. Frequently, this is interpreted as requiring reducing the term of existing REA notes or prepaying one or more notes, conditions which discourage the borrower from activities which would strengthen its overall financial stability and actually enhance the government's loan security.

In the past, REA has been more liberal than it is today in providing lien accommodations without exacting a "compensating benefit" for purposes which it itself could not finance. Sec. 7(2) of the bill would require lien accommodations "for any purpose that would enhance the financial strength or revenue or improve the efficiency, effectiveness, or financial stability of the borrower, upon a finding that the borrower has, or will have, the ability to repay its existing and proposed indebtedness."

The report on the bill should stress the need for REA to recognize that other lenders must receive lien accommodations on mutually satisfactory terms if REA borrowers are to be "encouraged and assisted to satisfy their credit needs" from "other sources at reasonable rates and terms," as set forth in sec. 1 of Public Law 93-32, May 11, 1973.

Sec. 7(3). Making Any Approved Lender Eligible for Guarantees

Sec. 7(3) amends sec. 306 to include in the definition of a "guaranteed loan" one made or refinanced by "any lender approved by the Administrator."

This would permit guaranteeing loans made or refinanced by lenders that are not organized primarily as "lending agencies," such as other electric and telephone utilities, manufacturers, or suppliers. Similar language appears in Sec. 7(2) of the bill so that liens may be accommodated or subordinated for any "lender approved by the Administrator."

Sec. 7(4). Promulgating Rules and Authorizing Lenders to Adjust Interest Rates

Sec. 7(4) adds a new subsection 306(b) to require the Administrator to promulgate rules for the guarantee of loans and the accommodation and subordination of liens or mortgages, and a new subsection 306(c) to authorize the lender of a guaranteed loan advance to adjust the interest rate on the advance, without penalty, if the interest rate exceeds the current rate on new advances by at least one full percentage point.

The new subsection 306(b) would give your committee and its counterpart in the Senate an opportunity to review the proposed rules before they go into effect. The new subsection 306(c) is similar to the new provision proposed for subsection 304(c). The principal lender under the REA guarantee is the Federal Financing Bank which has no provision for adjusting interest rates on its loans to REA borrowers with or without penalty. As indicated previously FEB has been borrowing short term to obtain cash for long term lending and could easily afford to make such adjustments which would reduce the interest burden on rural people served by borrowers with guaranteed loans.

C. REA Electric Loan Provision

Sec. 8. Maintaining 1983 Supplemental Loan Ratios for Electric Program

Sec. 8 amends sec. 307 to provide that 1983 criteria and ratios for supplemental financing in the electric program will be maintained in any fiscal year when the minimum loan level is established by law at less than one billion dollars.

This is considered necessary because of the frequent attempts by the current Administration to reduce the loan levels and increase the supplemental financing required. Increasing supplemental financing effectively increases the composite interest rate electric borrowers must pay. As this legislation will also increase interest costs for the same borrowers, further increases through increased supplemental financing would unduly burden the consumers served by the nation's rural electric systems.

D. Rural Telephone Bank Provisions

Sec. 9. Rural Telephone Bank Capitalization

Sec. 9 amends sec. 406(a) by striking "but not later than fiscal year 1991" from the second sentence. This is considered necessary to assure that authority for the Government's purchase of Class A stock in the Rural Telephone Bank is not terminated until the full amount authorized has been purchased. Present law limits

each annual purchase through fiscal year 1991 to no more than \$30 million. Without this change, a smaller purchase in any year would have the effect of permanently reducing the total amount of stock authorized to be issued by the Bank, thus depriving the Bank of capital needed to qualify more borrowers for Bank loans instead of the lower interest rate revolving fund loans.

Sec. 10(1). Limitation on Acquisitions With Telephone Bank Loans

Sec. 10(1) amends sec. 408(a) to eliminate the proviso that loans made by the Rural Telephone Bank for acquisition of telephone lines, facilities, or systems to improve the efficiency, effectiveness, or financing stability of borrowers require approval of the Secretary, and any exchange facilities for local services to be acquired shall not be greater in size than the borrower's existing system when it received its first bank loan. The borrower's first bank loan could have been made more than a decade ago when it was considerably smaller than it is today.

The current proviso is undesirable and should be eliminated because:

1. It can effectively prevent consolidation of territories to realize operating economies in today's competitive environment.
2. No limitations on size of acquisitions apply to the lower interest rate loans available from the revolving fund.

Sec. 10(2). Interest Coverage Requirement for Telephone Bank Loans

Sec. 10(2) amends par. (4) of subsection 408(b) to make the interest coverage ratio required for Telephone Bank loan eligibility more flexible and to have the ratio computed on a pre-tax instead of a post-tax basis.

Currently, to qualify for a Telephone Bank loan, a borrower must be able to produce net income before interest at least equal to 150 percent of the interest requirements on all existing and proposed loans, or such higher percent as may be fixed from time to time by the Telephone Bank Board in order to allocate available funds equitably among borrowers. By computing the interest coverage ratio before interest and income taxes, the proposed amendment would conform the calculation to accepted financial and industry practices and give to the Telephone Bank Board the flexibility needed to reduce as well as increase the ratio in order to make optimum use of funds available at any time from the REA and the Telephone Bank. When, for example, the Telephone Bank has ample loan funds available and REA has a shortage of loan funds for the telephone program, the Bank's board could lower the interest coverage ratio required for Bank loans and thus qualify more borrowers for Bank loans.

Sec. 10(3). Elimination of Nonduplication Finding for Bank Loans

Sec. 10(3) eliminates par. (5) of subsection 408(c) and its requirement for a nonduplication finding on Telephone Bank loans in those states where borrowers are not required to obtain a certifi-

cate of convenience and necessity. This is the same change as the one proposed for REA loans in sec. 2 of the bill. As set forth in the explanation of that section, this would not preempt the comprehensive state jurisdiction outlined in sec. 202 of the present law. It would, however, facilitate financing for interconnections with more than one long distance carrier by eliminating the presently required nonduplication finding in some 15 states and territories.

Sec. 11. Conforming Telephone Bank Reorganization Provision with Changes in Bill

Sec. 11 eliminates subsection 410(b) which presently releases telephone loans from the restrictions on acquisitions set forth in sec. 408(a)(2) when all class A stock of the Telephone Bank has been retired.

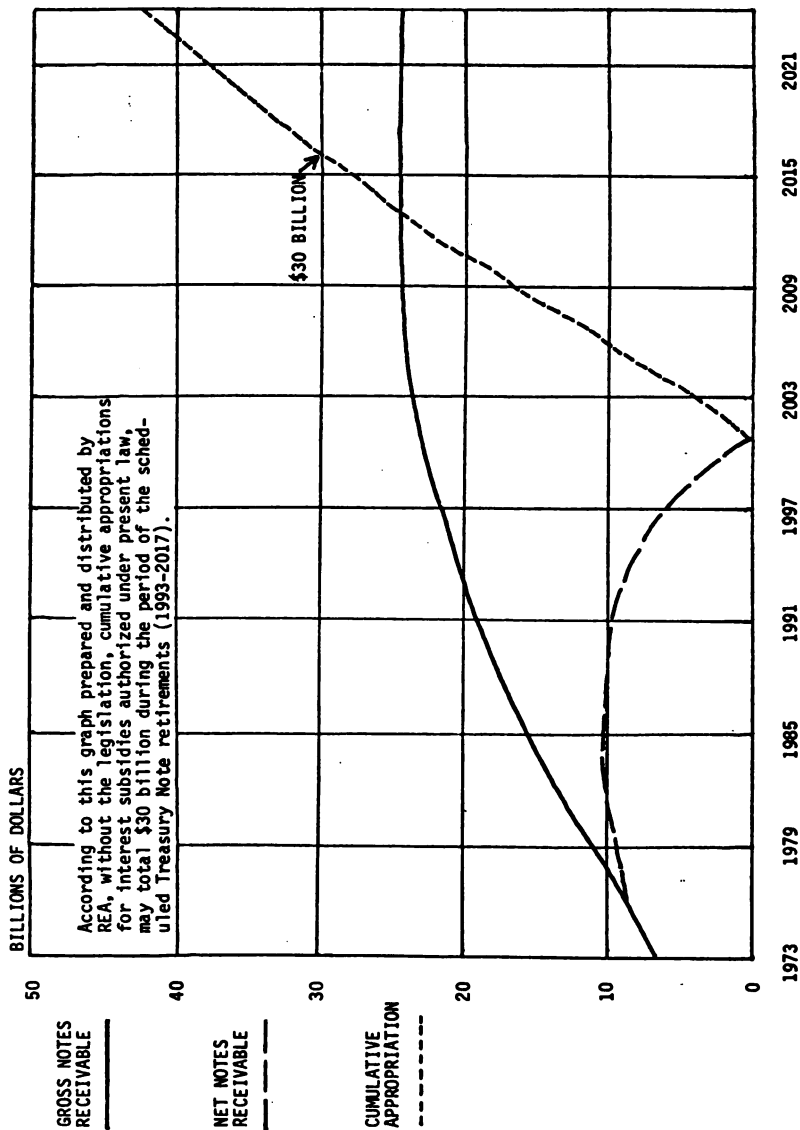
As previously indicated, Sec. 10(1) of the bill amends sec. 408(a)(2) to eliminate the restrictions referred to in sec. 11. If sec. 10(1) is enacted, there would be no need for sec. 410(b).

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I thank you for the opportunity to present this analysis. I hope it will help in understanding the many changes included in the bill and why they should be approved. I would be pleased to provide, or attempt to obtain, answers for you on any questions that you may have.

EXHIBIT 1

NOTES RECEIVABLE & CUMULATIVE APPROPRIATION



TESTIMONY OF
CONGRESSMAN BILLY TAUZIN
BEFORE THE
HOUSE AGRICULTURE SUBCOMMITTEE ON
CONSERVATION, CREDIT, AND RURAL DEVELOPMENT

MR. CHAIRMAN, THE ISSUE BEFORE THIS SUBCOMMITTEE TODAY IS WHETHER THE RURAL ELECTRIC CONSUMER WILL BE ABLE TO AFFORD ELECTRIC SERVICE IN THE FUTURE. AT STAKE IS THE VERY SURVIVAL OF RURAL ELECTRIFICATION.

THE OBJECTIVE OF THE RURAL ELECTRIFICATION PROGRAM HAS ALWAYS BEEN TO PROVIDE RELIABLE ELECTRIC SERVICE TO RURAL AREAS AT A REASONABLE COST. IN LOUISIANA RURAL ELECTRIFICATION IS STILL MEETING THOSE OBJECTIVES. MOST RURAL AREAS REMAIN UNPROFITABLE TO SERVE, WITH A DENSITY OF ONLY 7 CONSUMERS PER MILE OF LINE, COMPARED TO 35 AND 70 FOR INVESTOR AND PUBLICLY OWNED UTILITIES. LOUISIANA'S ELECTRIC COOPERATIVES OWN HALF THE MILES OF LINE IN THE STATE, BUT ACCOUNT FOR ONLY 6% OF THE STATE'S UTILITY REVENUES.

MORE IMPORTANTLY, MANY PARTS OF SOUTH LOUISIANA ARE STILL WITHOUT ELECTRICITY TODAY. REMOTE AREAS OF THE MARSH ARE POPULATED WITH HUNTERS, TRAPPERS, AND FISHERMAN WHO SPEND MUCH OF THE YEAR THERE EARNING A LIVING. MOST DO SO WITHOUT ELECTRICITY. THE COST OF EXTENDING LINES INTO THESE AREAS

IS TREMENDOUS AND WOULD PROBABLY NOT BE UNDERTAKEN BY INVESTOR OWNED UTILITIES CONSCIOUS OF MAKING AN ADEQUATE RATE OF RETURN. BUT THROUGH THE RURAL ELECTRIFICATION PROGRAM, A LOCAL COOPERATIVE RECENTLY EXTENDED LINES TO OVER 500 OF THESE REMOTE CONSUMERS AND AT RATES THEY CAN AFFORD.

HOWEVER, THE ABILITY OF LOUISIANA'S 1 MILLION RURAL CONSUMERS TO CONTINUE RECEIVING ELECTRICITY AT AFFORDABLE RATES IS UNCERTAIN. THE PRIMARY SOURCE OF CAPITAL FOR RURAL ELECTRIFICATION IS IN DANGER OF BEING DEPLETED. REPAYMENTS OF OLD LOANS INTO THE REVOLVING FUND ARE INSUFFICIENT TO MEET NEW LOAN REQUIREMENTS. ADDITIONAL FUNDS MUST BE BORROWED FROM THE TREASURY AT MARKET RATES. INTEREST EXPENSE WILL EXCEED INTEREST INCOME BY 1986. INCLUDED IS A PROVISION IN THE BILL TO CORRECT THIS IMBALANCE.

PASSAGE OF HR 3050 WILL INCREASE THE COST OF NEW LOANS TO RURAL ELECTRIC COOPERATIVES. BUT WITHOUT GOVERNMENT BACKED LOANS, THEY WILL HAVE TO TURN TO THE PRIVATE SECTOR FOR FINANCING AT EVEN HIGHER INTEREST RATES. INTEREST EXPENSE ALREADY ACCOUNTS FOR ONE-THIRD THE COST OF ELECTRICITY PRODUCED FROM NEW GENERATING PLANTS IN LOUISIANA.

THE SURVIVAL OF RURAL ELECTRIFICATION IS DEPENDENT UPON AFFORDABLE RATES. WE AS REPRESENTATIVES CAN HELP ASSURE THEY REMAIN AS LOW AS POSSIBLE. I FULLY SUPPORT THIS BILL AND THE RESPONSIBLE MEASURES IT UNDERTAKES TO MAINTAIN THE LONG RUN VIABILITY OF THE RURAL ELECTRIFICATION REVOLVING FUND.

STATEMENT OF
A. HAROLD PETERSON
on behalf of
THE NATIONAL REA TELEPHONE ASSOCIATION
before the
SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT
of the
HOUSE AGRICULTURE COMMITTEE
October 4, 1983

Mr. Chairman and members of the Committee,

My name is A. Harold Peterson. I am the Executive Director and Counsel of the National REA Telephone Association. This association is comprised of the privately-owned telephone companies who borrow their capital needs from the Rural Electrification Administration. Accompanying me here today is Mr. Robert S. McClelland of Columbia, Missouri, who is the President of our Association and Mr. John F. O'Neal of Washington, D.C., who is the association's Associate Counsel. We appreciate the invitation and opportunity to appear before your committee to support H.R. 3050, the Rural Electrification and Telephone Revolving fund Self-Sufficiency Act of 1983.

REVIEW OF REA TELEPHONE PROGRAM HISTORY

The telephone amendment of the REA act was signed into law on October 28, 1949, thirty-four years ago. During the ensuing years there have been major changes to the REA act. The

last major changes occurred in 1973. Today, there remain only two United States Senators and six Congressmen who were in the Congress when this legislation was adopted. Only thirty-three Senators and 129 Congressmen in the present Congress were members ten years ago. Today we appear before your committee knowing that you, Mr. Chairman, are the only member of this subcommittee who was in Congress when the major changes to the REA act were made in 1973. There are only seven members of the full committee who were in the Congress ten years ago. It seems appropriate, therefore, that we review some of the history of the REA program to sharpen your focus and perspective as you begin consideration of the changes suggested in H.R. 3050. While both the electric and telephone program are involved, we will limit our historic discussion to the telephone segment only.

In 1949 there was scattered throughout our country over 5,000 telephone companies most of whose facilities were built during the period from 1900 to 1920. For the most part, these facilities comprised the old magneto and common battery systems with open wire outside plant. In many instances a single pair of wires served as many as 25 customers. Our own telephone company in Chisago City, Minnesota where I live had just such a system until rebuilding commenced in 1955 under the REA telephone program. These old systems were forty to fifty years old in 1949 and were badly in need of rebuilding. The problem was that there was no bank, insurance

company or any other lender willing to lend the money that was necessary to rebuild and extend these telephone systems. Simply put, a financial vacuum existed throughout rural America wherein there was little or no hope of attracting the necessary debt capital to modernize these systems. It was in this time of helplessness in which these telephone companies found themselves that the Congress of the United States looked at the tremendous achievement that was being accomplished in bringing electricity to rural America and decided that the same kind of program could be utilized to bring modern telephone service to rural America. Thereupon, the Congress acted and passed the telephone amendment to the REA act which was signed into law on October 28, 1949. The statement of Congressional policy indicated: "...that adequate telephone service be made generally available in rural areas through the improvement and expansion of existing telephone facilities and the construction and operation of such additional facilities as are required to assure the availability of adequate telephone service to the widest practicable number of rural users of such service." The first loan was made in 1950 to the Florida Telephone Company in Alabama. In the early years the REA standard of service in rural areas required that there be no more than eight customers on one line. The critics of the program in those days railed that this was gold plating, irresponsible, economically unsound and that the companies would be unable to repay the loans. How wrong

the critics of those early days were will be covered later in our statement when we explain the accomplishments of the program.

As the telephone program developed, the capital needs in both the electric and telephone segments increased. As the early sixties approached, there was not only pressure to eliminate the 2% interest rate at which the loans were being made, but there was pressure to look for supplemental sources of financing for both the electric and telephone programs. After repeated attempts failed to establish a bank for both the electric and telephone borrowers in the sixties due to the strident opposition of the investor-owned electric utilities, the electric borrowers embarked in a different direction and established what is now known as CFC. We continued the battle on the telephone side to set up a rural telephone bank within the Department of Agriculture. This was finally accomplished in 1971 after a six year struggle. The Rural Telephone Bank was signed into law in May of 1971. It was patterned after the Farm Credit System which had proved to be so successful over the past 50 years. The RTB is an instrumentality of the United States Government; it has a 13 member board of directors, three of whom are elected by the cooperative-type entities who borrow, and three of whom are elected from the private entities. The REA Administrator is by law Governor of the bank. Provision is made for eventual

conversion to private ownership, as was the case in the Farm Credit System, which today is a totally private banking institution. Since 1971 the RTB has been a very valuable source of supplemental financing for those companies who have matured enough financially to be able to pay a higher rate of interest. The present bank lending rate is now 10%. It has been as high as 12.25%. In the early years it was 8%. From its inception to date, the Rural Telephone Bank has made over \$1.5 billion in loans.

In 1973 major changes in the REA act occurred, one of which was the creation of the "Rural Electrification and Telephone Revolving Fund". In addition, there were changes in the interest rate. A "standard rate" of interest of 5% was established to replace the previous 2% rate for most borrowers. The rate of 2% was retained for those borrowers who met a specified criteria. In addition, the Administrator was authorized to make 2% loans in hardship cases. The 1973 Act also provided for the Administrator to guarantee loans made by other lenders. To date the Federal Financing Bank, an arm of the U.S. Treasury, has been the primary lender of the guaranteed loans. The "special rate" loan program was eliminated in a 1981 amendment to the Act so that loans are now made at a 5% rate of interest from the Revolving Fund except for hardship cases where the Administrator is still empowered to make a loan at a lesser rate than 5%. Over the 34 year history of the telephone program, as the borrower's

financial ability and maturity of the borrowers increased, the interest rate paid by the borrowers has increased: from the original 2% rate which existed until 1971 to a standard rate of 5%, to a Rural Telephone Bank which has ranged between 6.5% to 12.25%, and finally, a Guaranteed loan rate which equals the government's cost of money in the private market.

PROGRAM ACCOMPLISHMENTS

The REA program, both electric and telephone, has brought untold economic and social benefits to rural America during these 34 years. Consider the following facts: In 1949 only 38% of the nation's farms had a telephone compared to 95% at the end of 1982. In 1950 the program served 29,000 customers from 17 companies. Today over 4.5 million customers are served by 1,028 REA telephone companies which comprise 72% of the nation's 1,432 independent telephone companies. In 1958 only 4% of REA customers had one party service, compared to 82.5% at the end of 1982. Where feasible, new digital switching equipment is replacing the old electro-mechanical type in the central offices. Buried cable is replacing open wire, outside plant in order to escape the costly ravages of turbulent weather.

It can truly be said that the REA telephone program has brought modern telephone service to Rural America equal to that rendered in urban areas. Our member companies are very

proud of this accomplishment. We are also proud of the fact that there has never been a default on a loan in the entire 34 year history of the REA telephone program, in which over \$6.5 billion has been loaned. We know of no other Federal program that can come close to matching the record of REA, both electric and telephone. It is a tribute to those electric and telephone entities who accomplished this record, but in a larger sense, it is a tribute to the Congress of the United States, who in its wisdom, saw the need and met it with a legislative policy that made all of this possible. This Committee has played the major role over the years in making this record possible. For this, our association is extremely grateful. Our companies will continue to do their utmost to continue this fine record. In spite of all that has been accomplished, the job is not yet over. There are countless homes in the United States still without a telephone. Last year alone, over 170,000 REA telephone subscribers were added to the rolls. REA added 14 new borrower companies last year. We hope that this history of our program which we have recited will enable those members of Congress who are not acquainted with our record to have a clearer understanding of the program and its current needs.

CURRENT TELECOMMUNICATIONS ENVIRONMENT AND EFFECT ON
REA PROGRAM, BORROWERS AND CUSTOMERS

One needs only to reflect on what the media has told us during the past year to know that a gigantic transformation

is taking place in the telephone industry today. The court ordered divestiture of the Bell System and Federal Communication Commission orders, which will take the industry from a regulated monopoly to a competitive environment, has every telephone company in the United States wondering what the end result will be. The industry which has brought our nation the finest telephone system in the world at reasonable rates is undergoing vast change. Last year 64% of the total operating revenues of all REA telephone companies were derived from the long distances revenues generated throughout the nation. We are told that this is a subsidy that cannot continue in a competitive environment. We are told by the FCC that this cost must be shifted to the end user of the service as the cost-causer, namely the residential and small business customer. Without attempting to provide a detailed analysis on what is happening in the Courts, the FCC and in other Committees of Congress, we do want to cite several of our concerns. First of all, the "competition" which is being so widely discussed will not benefit rural America. It will benefit the long distance carriers who have targeted about 135 American cities whose population exceeds 100,000 people. This is where the "big bucks" are generated for long distance calls. These are the high-density, low-cost areas of our country. REA telephone companies serve the low-density, high cost areas of our country. People are being told that rates will more than double in the urban areas of our nation. We

are concerned, and we know you are too, about how high they will go in rural America. The Commerce Committees of both houses of Congress have been addressing this issue for the past seven years. They have been told by economists that service has to be driven to cost in a competitive environment. They have been told by economists that if something is not done to correct the present method of toll settlement procedures in the country that many large businesses will by-pass the local telephone company and build their own system. All of this is being done in the name of encouraging new technologies. Just last week the Communication Subcommittee of the House Commerce Committee voted out a bill. Two days later the Senate Commerce Committee voted out a bill. The thrust of the Senate bill is to put a moratorium of the FCC order which is to go into effect on January 1, 1984 regarding the flat user charge imposed on residential and one line business customers. Many people, including members of Congress, are vitally concerned about the future because the Chairman of the FCC himself has testified that he does not know what effect the order will have on telephone rates. At the moment it appears that there may be legislation enacted to allay the fears of those of us who live in and serve rural America's telephones. Both bills recognize that there is a problem out there in rural Amrica and seek to alleviate the blow by establishing a "Universal Service Fund" which our REA companies can turn to for help.

This is a far too brief picture to describe what is happening in such a technical and complicated industry. We do want the Committee to know that the Rural Telephone Coalition has been working hard for the past four years to protect the interests of rural America. We will continue to need your support and interest in this endeavor if we are to be successful. An important aspect of this effort is a viable REA program. From time to time legislative improvements are necessary to accomplish this objective. H.R. 3050 provides needed and timely changes in this respect.

PURPOSES OF AND NEED FOR H.R. 3050

Recognizing the ongoing need for a viable REA telephone program and the changing environment of the telecommunications industry occasioned by competition and new technology changes in the Rural Electrification Act are both necessary and desirable.

It has been 10 years since this Committee last considered major revisions to the Rural Electrification Act. During this period, we have witnessed unprecedented inflation in our society which caused an inordinate drain upon the resources of the revolving fund -- far beyond the requirements for capital anticipated by Congress when the fund was created in 1973. The fund's main source of income, repayments from borrowers on outstanding loans, simply has not been adequate to meet the increasing demand for new loans authorized annually by Congress. In addition, as interest rates increased during

this period, the interest expense on fund borrowing has escalated dramatically. The following chart provided by REA graphically demonstrates these points:

THE RURAL ELECTRIFICATION AND TELEPHONE REVOLVING FUND (RETRF)

(Dollars in Millions)

<u>Fiscal Year</u>	<u>LOAN PAYMENTS RECEIVED</u>		<u>RETRF OUTLAYS</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Advance to Borrowers</u>	<u>Interest Paid</u>
1973	\$ 20.3	\$ 21.4	\$ 92.4	\$ 0.0
1974	173.1	144.2	802.4	0.0
1975	204.0	174.3	854.9	0.0
1976	299.2	252.3	1027.9	11.4
1977	275.2	234.9	874.9	29.6
1978	303.1	268.1	881.4	33.3
1979	313.8	296.9	1105.2	79.1
1980	349.1	336.9	1206.8	144.1
1981	363.1	382.7	1203.8	288.4
1982	389.3	425.8	1048.0	316.5

Source: Rural Electrification Administration, U.S.D.A.

These two factors have combined to create a situation of imbalance which has caused REA Administrator Hunter to predict that by 1986 the amount of interest paid out by the fund will be more than the interest income it receives. This has prompted him to comment, "At that time, the revolving fund will begin eating its seed corn."

The financial resources of the revolving fund will be even further depleted when, in 1993, the fund will be required to begin repayment to the Treasury of the Administrator notes. These notes amounting to 7.8 billion dollars, come due from 1993 to 2017. They were made liabilities of the revolving fund when it was created in 1973; however, no provision was made for their retirement or repayment in that legislation. These notes arose primarily in connection with the REA direct loan program which existed from the program's inception through 1972. Funds were appropriated each year by the Congress to meet the program's needs. The Administrator was authorized under the Act to "borrow" the necessary amounts from the Treasury for re-lending to program participants. As repayments were made under the program the Administrator would in turn satisfy his Treasury "notes", crediting the oldest notes first. This, of course, was largely a bookkeeping transaction since the repayments flowed directly from borrowers into the Treasury. Appropriations for the direct loan program ceased in 1972 and Congress replaced the direct loan program with the insured loan program, establishing the revolving

fund to provide the necessary initial capital. Rather than cancelling the Administrator's notes at that time (which would have effectively provided an ongoing source of lending capital), they were made liabilities of the revolving fund.

There are a number of ways the fund's current financial dilemma can be solved. Congress could appropriate additional funds into the revolving fund to expand its capital base. This would, of course, require new outlays and would have a significant budgetary impact. Appropriations to the fund are authorized under existing law and could be made similar to the reimbursement procedure utilized each year for the Farmer's Home Administration Revolving Fund or that of the Commodity Credit Corporation.

Another alternative also authorized under existing law would be for the fund to simply "borrow" the additional funds necessary from the Treasury to satisfy the notes to the Treasury as they come due. Rolling over debt capital in the public utility business is a common practice but this exercise would simply increase the interest costs of the fund and unduly raise the borrowing costs under the program.

The alternative recommended in H.R. 3050 seems to us to be the most desirable and least costly. It would authorize retention of the notes as additional equity capital in the fund thereby making repayments by borrowers during this period available for program relending (at the levels authorized annually by the Congress) rather than for general government

expenditures. It would be the least costly of the three alternatives discussed since it would not require any new budgetary outlays nor would it increase governmental borrowing.

An equally significant change will increase revenue to the fund by raising the interest rate to borrowers, upon enactment, to a rate necessary to balance the fund's interest expense and interest income. There is presently a 5% maximum statutory interest rate. This change, which our Association endorses, will ensure that all future "standard rate" loans from the fund will be made at the fund's cost of money. While we are striving to keep all of our costs at a minimum, particularly, interest costs, we recognize that preservation of the fiscal integrity of the revolving fund for future borrowers is also an important objective. This change should signify to all concerned that the participants in the program are willing to share in the responsibility for preserving the integrity of the fund.

These two changes incorporated in H.R. 3050, capitalizing the Administrator Notes and providing for an adjustable "standard" rate of interest, will ensure a viable, balanced revolving fund for the foreseeable future, reducing the need for additional borrowing or congressional appropriations.

H.R. 3050 also provides several needed Act improvements in other areas. The Act will be updated to accommodate competition in the telecommunications industry, new technology, industry consolidation and further facilitate the transition to supplemental financing sources.

Competition

When the telephone amendment was adopted in 1949 the nation's rural telephone companies were fully regulated monopolies with protected territories and assured revenue bases. For the most part, this meant stable rural telephone rates. With the implementation of FCC policies designed to encourage competition, this environment is rapidly changing. The traditional revenue base of the average rural telephone company is eroding due to competition and, frankly, no corresponding benefits are emerging. All of this works to the disadvantage of the rural ratepayer. If rural telephone rates are to remain comparable with their urban counterparts, rural telephone companies must be free to offer new or enhanced services which in some cases may be duplicative of other facilities. Yet, the Rural Electrification Act currently prohibits loans which duplicate facilities. In those states where no regulatory commission exists, H.R. 3050 would eliminate this prohibition permitting loans if other Act loans purposes are met. This is a needed improvement. This change does not preempt state regulatory jurisdiction, however, in any way. That authority is preserved in Section 202 of the Act.

New Technology

The definition of "telephone service" in the Act was written 21 years ago in 1962. During the intervening years there have been dramatic advances in telecommunications technology: analog to digital switching equipment, fiber optics, and transmission of data as well as voice communications, to name only a few. H.R. 3050 takes these technological changes into account in a new, improved definition of "telephone service" without disturbing the historical boundaries in the Act between telecommunications and CATV and broadcast radio.

Industry Consolidation

With the advent of competition, consolidation in the telephone industry is inevitable. Presently there are almost 1500 companies furnishing telecommunication services in this country. Many are small rural companies in high cost areas which simply cannot economically support competition. The evolution towards consolidation began some years ago but it will be hastened by this new environment. Economies of scale will require that many service territories be consolidated. Many large telephone companies will also divest companies and territory as they strive to produce a more efficient, competitive operation. We are already seeing this take place in many areas. Bell operating companies have approached member companies of our association in past months seeking to divest operating territories which do not fit their future operating scheme. From the government's point of view, as well as that

of the rural ratepayer, it is desirable for REA borrowers to be able to consolidate and effect operating economies in today's competitive environment. However, the Act currently contains limitations upon the ability on a REA borrower to acquire additional service areas with Rural Telephone Bank funds. H.R. 3050 corrects this by eliminating the size limitations on acquisitions of exchange facilities which can be financed by the Rural Telephone Bank, an important change.

Another Act restriction upon the ability of REA borrowers to consolidate territories is the population limit of 1500 which is contained in the definition of "rural area." Excluded from financing are service areas of communities with over 1500 inhabitants. Often a REA-financed service area will surround one or more small communities in excess of 1500. However, financing is not available to serve these small towns because of the Act's population limit. Moreover, the utility serving the small town may want to consolidate territories with the outlying REA borrower but is precluded from doing so with REA loan funds. We believe the current limit of 1500 in the Act is outdated and that the increase to 2500 proposed by H.R. 3050 is a reasonable and necessary change.

Transition to Supplemental Financing Sources

The Rural Telephone Bank legislation enacted in 1971 contained the following statement of Congressional policy:

"... the growing capital needs of the rural telephone svstems require the establishment of a rural telephone bank which will furnish assured and viable sources of supplementary financing..." The Rural Telephone Bank has certainly lived up to its promise having loaned out over 1.5 billion dollars since its inception. However, one of the Act's provisions hinders its ability to accept additional graduates from the insured loan program and from further fulfilling its Congressional mandate. The Act requires that to be eligible for a bank loan a borrower must have the capability of producing net income or margins before interest at least equal to 150% of the interest requirements on all of its outstanding and proposed loans or such higher percentage as may be fixed by the telephone bank board to allocate available funds equitably among borrowers. The computation is made on a post income tax basis. H.R. 3050 would improve RTB loan eligibility by permitting the bank board to lower the interest coverage test and to compute it before income taxes. This change would make the RTB more flexible so that more borrowers who are able to pay more than the standard rate of interest could qualifv for RTB financing.

Also, by eliminating the reference to "1991" in the RTB capitalization section of the Act (Sec. 406), the bank's authorized capitalization can be achieved without regard to a specified time limit. This means that if Congress defers appropriating a portion of the authorized capital in a given

year for budgetary or other considerations that amount could be made up sequently to achieve full capitalization of the bank.

Other important sources of supplemental financing for rural electric and telephone svstems are provided through guaranteed loans and the accommodation and subordination to other lenders of REA's first lien on the property of the borrower. The changes suggested in H.R. 3050 will materially improve the ability of borrowers to seek non-REA sources of financing. This is particularly important for telephone borrowsers who must have the ability to finance for non-Act purposes to replace their eroding revenue base in the new competitive environment. One of these changes will direct the Administration to accommodate or subordinate liens or mortgages at the request of the borrower for any purpose that would improve the "efficiency, effectiveness or financial stability of the borrower" upon a finding that the borrower has, or will have, the ability to repay its debt.

Improvements in the guaranteed loan program recommended in H.R. 3050 will make it more flexible and viable as a supplemental source of financing.

Finally, Mr. Chairman, I want to mention a change which falls simply into the category of a desirable Act change. H.R. 3050 provides that the revolving fund be divided into separate electric and telephone sub-accounts. This division of the fund, while preserving overall program homogeneity, will better enable each program segment to stand on its own.

Each program will also be better able to meet its future future financial requirements in a changing enviroment through subaccounts which will reflect each program's assets, liabilities, equitv, income and expenses.

Overall, Mr. Chairman, H.R. 3050 makes many important and needed improvements to the Act and to each respective program. Our Association wholeheadedly supports its enactment.

Testimony of

JAMES W. DAMON

on behalf of the

UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION

submitted to the
SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT
COMMITTEE ON AGRICULTURE

October 4, 1983

Mr. Chairman and Members of the Subcommittee, I am James W. Damon, President of the Oregon Telephone Corporation, Mount Vernon, Oregon, appearing before you as a representative of the United States Independent Telephone Association (USITA). I currently serve as a member of the REA Borrowers Committee of USITA.

Oregon Telephone Corporation is one of 1432 Independent (non-Bell) telephone companies in the United States. I am pleased to have this opportunity to appear before you and testify in support of H.R. 3050, the Rural Electric and Telephone Revolving Fund Self-Sufficiency Act of 1983.

We believe that the changes in the Rural Electrification Act of 1936 proposed in H.R. 3050 constitute responsible and needed improvements in the REA program. They are particularly vital to the successful operation of the telephone program. In addition, we believe that H.R. 3050 is a sound approach to the problem of the imbalance in the revolving fund. It is certainly the alternative least costly to the government if we are to maintain a viable REA program and a fiscally-sound revolving fund for the future. USITA supports enactment of this important legislation and commends the sponsors for its introduction.

Mr. Chairman, the telephone industry is currently undergoing unprecedented and dramatic change. On January 1, 1984, the court-ordered divestiture by the American Telephone and Telegraph Company of its regional operating companies is to occur. Also, on January 1, 1984, the access charge order of the Federal Communications Commission, is scheduled to be implemented. In addition, our industry is witnessing almost unbelievable technological changes many of which cloud traditional distinctions between competing methods of communication. This age in which we live properly labeled "The Information Age" is an exciting time to be involved in the field of telecommunications. Exciting indeed, but, monumental change creates uncertainty and, in a capital intensive industry like the telecommunications industry, uncertainty creates problems.

As I mentioned, the job is not over. In many respects, it may just be beginning. The need for capital has never been greater in our industry. The technological revolution which we are experiencing will make much of our existing plant and facilities obsolete. To meet the new demands of competition in our industry, upgrading of our equipment is necessary if we are to provide the equal interconnection access envisioned by the FCC. And, there are still unserved households in rural America -- some estimate as many as 5 million or more without telephone service. Hence, the REA telephone loan program serves the public interest as much if not more than ever.

It is, of course, equally important that the Act itself keep pace with the times. The last major revision of the Rural Electrification Act occurred in 1973 when the insured and guaranteed loan programs were created along with the revolving fund. Since then the revolving fund has served as the sole source for REA insured loans. Repayments of principal and interest by borrowers together, with the sale of certificates of beneficial ownership (CBOs) to the Federal Financing Bank have provided the required funds for new loans. The fund was originally designed to be largely self-sustaining but high interest costs and greatly accelerated capital needs occasioned by inflation have eroded the capital base of the fund. By 1986 it is likely that the fund will move into a deficit position requiring a drastic reduction in loan availability, increased costs of borrowing or some further legislated assistance.

Fortunately, even in this revolutionary environment, the REA telephone program provides an important and stabilizing bulwark for rural telephone companies and their customers. Access to adequate capital is vital to a public utility. In high cost rural areas of our country, capital just would not be available if it were not for the lending programs of REA. The REA has made it possible for millions of rural Americans to have affordable telephone service of a quality comparable to the urban areas. In authorizing the telephone loan program, Congress directed that it be conducted to "assure the availability of adequate telephone service to the widest practicable number of rural users". As of January 1, 1983, REA figures show that 1028 telephone company borrowers had over 7 million telephones in service providing service to 5.1 million customers, 84.2% of which have one-party service. To get this job done, REA has approved more than \$6.7 billion dollars in loans and loan guarantees to finance 891,724 miles of line in 46 states to 258 cooperatives, 766 commercial companies and to 4 public bodies since the first telephone loan was made after enactment of the telephone amendment on October 28, 1949.

Approximately \$1 billion already has been repaid. There has never been a default in the 34 year history of the REA telephone program. Truly, this is a record of which, as taxpayers, we can all be proud. However, it should be noted that the companies providing this service still only have an average net worth of 26%.

H.R. 3050 provides a remedy now by increasing the interest rate to borrowers by the amount necessary to balance the fund's interest expense and by exchanging the outstanding notes to the Treasury when they begin coming due in 1993 for additional equity capital in the revolving fund. This would mean that borrower repayments of principal and interest would be retained as capital within the fund for re-lending under the program rather than being generally available for other government expenditures.

There is no giveaway here. These funds will continue to remain in the U.S. Treasury until they are authorized for re-lending by the Congress.

All REA borrowers will repay their loans just as they always have. No obligation is being forgiven and no right is being lost by the government. It is simply a matter of maintaining the financial integrity of the revolving fund by providing the capital from borrower repayments rather than additional borrowing from the Treasury or the private market or for additional Congressional appropriations. Capitalization of these outstanding notes restores the capital base of the fund and assures a continued commitment by the Congress to rural America through this important program.

Other changes proposed in H.R. 3050 are necessary to integrate into the Rural Electrification Act the mandate for competition in our industry ordered by the FCC. The Act was

written when borrowers all had territorial protection for their exclusive service areas as regulated monopolies. Indeed, to preserve government resources, a finding of non-duplication of facilities was required as a prerequisite to the making of an REA loan in those states without a state regulatory commission. In a competitive environment, of course, there must be duplication of facilities; therefore, this prohibition has been eliminated. This will be particularly helpful in converting much of our present switching equipment to the more sophisticated digital type to permit equal access to our local service territories to common carriers, other than AT&T. This change, however, does not affect, in any way, state authority to regulate telephone service which is preserved in Sec. 202 of the Act. There is no preemption of state authority in the bill and in those states with a regulatory body to regulate telephone service their authority would continue as under present law.

Mr. Chairman, another updating provision H.R. 3050 is Section 3 which, revises the definition of "telephone service" to specifically include transmission of "data". It also substitutes for the requirement that electricity be utilized between the transmitting and receiving apparatus references to modern transmitting methodology of fiber optics and light as well as radio or other visual or electromagnetic means. These changes will bring the statutory definition of "telephone service" in line with current technology.

Another change in this section would permit REA loans to be made to serve inhabitants of cities, towns and villages of 2500 or less, increasing the current statutory limit from 1500 or less. This change is necessary to consolidate service territories which in many areas have a small town or village in their midst. Under current law, the Administrator cannot make a loan in such an area even though it logically falls within a borrower's natural local service territory. This is a real handicap in the current environment, since consolidation of territories is desirable and necessary if many small companies are to continue to have a viable revenue base.

Up to now, over 60 percent of the average REA company's revenue has come from long distance calls. With interstate long distance competition and the loss of traditional long distance settlement procedures, that contribution of revenue can no longer be counted on and will eventually erode. If reasonable local service rates comparable to the rest of the country are to be maintained in these high cost, rural areas of our country, consolidation of territories must occur. REA will be a participant in this process since they hold a first mortgage on all of the property of these borrowers and therefore, would be the only available financing source.

Another change which will facilitate desirable consolidation of service areas is the elimination of the statutory limitation on the size of acquisition which can be financed by the Rural Telephone Bank. Current law provides that, in acquisitions involving local service exchange facilities, the borrower cannot acquire a system greater than its own at the time of its first loan from REA.

Also, eliminated would be a little-used procedure requiring the Secretary of Agriculture to approve pursuant to a finding, in RTB loans for other acquisitions of "telephone lines, facilities or systems", that the location and character of the acquisition is such that it will improve the efficiency, effectiveness or the financial stability of the telephone system of the borrower. This duplicates a similar requirement imposed upon the Governor of the Telephone Bank under existing Section 408(a)(2).

When the Rural Telephone Bank legislation was adopted, it was contemplated that borrowers who were at lower interest rate levels would graduate to the higher interest rate capital of the Rural Telephone Bank as their system became more financially stable. Unfortunately, the needs test was written in such a way that the RTB had little flexibility in qualifying additional borrowers for bank loans. One of the problems has been the interest coverage test which was statutorily established at 150%.

The board was given the authority to raise the percentage but not to lower it to qualify additional applicants. This has resulted in a disincentive for bank loans to borrowers. The problem is corrected in H.R. 3050 by authorizing the Bank board to lower as well as raise the interest coverage ratio to qualify additional borrowers. Another change requires the board to compute the ratio on a pre-income tax basis rather than a post-tax basis bringing the test more into line with commercial lending practices.

These two changes will combine to produce a more flexible RTB lending program in furtherance of the Congress' original objectives in establishing the Rural Telephone Bank.

Two additional changes, affecting both the electric and telephone programs merit specific comment. One proposes to divide the revolving fund by creating separate electric and telephone sub-accounts. This is a sound change, Mr. Chairman, since it will require that each program stand on its own and yet not disturb the traditional homogeneity of the REA program. There will still be only one revolving fund within the U.S. Treasury but each program will be accounted for separately. The second, and more dramatic change for the telephone sector, is the

improvement suggested in the guaranteed loan program section of the Act (sec. 408). The Administrator is directed, under H.R. 3050, to provide financial assistance to borrowers through guaranteed loans or by accomodating or subordinating liens or mortgages to encourage and assist borrowers to develop and achieve necessary financial strength to satisfy their credit needs from other sources and to improve their financial stability. In addition, the Administrator shall accomodate or subordinate, at a borrower's request, for any purpose that would enhance its financial strength or improve its efficiency, effectiveness or financial stability upon a finding of an ability to repay by the borrower. It is vitally important to the welfare of telephone borrowers that these changes be made.

I have referred to the necessity and desirability of consolidation in the telephone business in the present deregulation environment. Just as important is the need to diversify to offset revenue losses in traditional telephone service operations. If rural consumers are to benefit at all from deregulation and competition in the telephone industry, then telephone companies must be permitted, even encouraged, to diversify their operations. The restrictive administrative policies of the present Administration are the most significant deterrent to the successful diversification of REA telephone

borrowers. Since REA has a lien on all property of the borrowers (whether now owned or hereafter acquired) diversification of plant and facilities cannot occur without the cooperation and approval of REA. Up to now, this cooperation and approval has not been forthcoming. This change would ensure that this dilemma of REA borrowers is alleviated.

To sum up, Mr. Chairman, the changes in the Rural Electrification Act proposed in H.R. 3050 are important and desirable improvements. They would strengthen and enhance the insured and guaranteed loan programs of REA. They would ensure that the revolving fund remain fiscally sound and financially solvent for the foreseeable future without the need for the injection of further capital. Most importantly, the Act would signal to those in rural American that the Congress is not shrinking from its commitment made long ago when it passed the Rural Electrification Act that those living in sparsely-populated sections of our country will have dependable and affordable electric and telephone service. In this "Age of Information" dependable communications is not a luxury, it is a necessity.

Thank you again for this opportunity to present USITA's views in favor of H.R. 3050.

TESTIMONY OF
CONGRESSMAN TOM DASCHLE
BEFORE THE
SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT
COMMITTEE ON AGRICULTURE
U.S. HOUSE OF REPRESENTATIVES

OCTOBER 4, 1983

Chairman Jones and other members of the Subcommittee, in a speech to the House of Representatives advocating passage of the Rural Electrification Act of 1936, Congressman Maury Maverick of Texas said, "The program contemplated in this legislation pending before this House would harm no person or legitimate interest and would help the whole nation." Today, as this Subcommittee begins its consideration of H.R. 3050, the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983, I, too, believe the program contemplated in the legislation pending before this Subcommittee would harm no person or legitimate interest and would help the whole nation. As an original cosponsor of this vital legislation, I look forward to the consideration of this measure by the Subcommittee on Conservation, Credit, and Rural Development, on which I am pleased to serve, and I commend and compliment the gentleman from Tennessee, the able and dedicated Chairman of this Subcommittee, for his authorship of this landmark legislation.

In the nearly half century which has passed since the Rural Electrification Administration was created, revolutionary changes have occurred in America, not the least of which have been the electrification of the farm and our rural areas. Today, 30 million Americans are provided essential and reliable electric service by rural electric systems which are predominantly consumer-owned nonprofit

cooperatives.

Fifty years ago, the establishment and provision of reliable electric service in rural America seemed to be a distant, even unattainable, dream. Kerosene lanterns, wood stoves, and water pumped by hand were not romantic nostalgia, but the stark reality of daily life on the farm. Less than one farm in ten nationwide had the "luxury" of electric service.

The dream of rural electrification has been transformed into reality because financing on terms and conditions which made affordable electric service possible has been provided by the Rural Electrification Administration. Modern telephone service is also being provided today to nearly 5 million rural Americans because telephone service system financing was made possible by the Rural Electrification Administration.

The Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983 will assure in the future the continued provision of essential, reliable, and affordable electric and telephone service in rural America. This legislation by insuring the continued financial solvency of the rural electrification and telephone revolving fund will enable rural electric and telephone systems, including the 33 electric distribution cooperatives and 3 electric supply cooperatives in South Dakota which currently provide service to more than 80,000 members and the 14 South Dakota telephone cooperatives which provide service to more than 60,000 subscribers, to continue to obtain necessary financing.

The Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act is as important to the provision of electric and telephone service in rural America in the future as the creation of the Rural Electrification Administration 48 years ago has been to the past half century of progress. Again, I compliment the Chairman of the Subcommittee for the introduction of this vital public interest legislation and I look forward to the consideration of this measure by the Subcommittee on Conservation, Credit, and Rural Development.

Byron L. Dorgan

STATEMENT OF

CONGRESSMAN BYRON L. DORGAN

NORTH DAKOTA

COMMITTEE ON AGRICULTURE

SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

ON THE

RURAL ELECTRIFICATION AND TELEPHONE REVOLVING FUND

SELF-SUFFICIENCY ACT OF 1983

OCTOBER 4, 1983

MR. CHAIRMAN:

I am pleased to be a cosponsor of H.R. 3050, which restores balance to the Rural Electric and Telephone Revolving Fund. Rural electric cooperatives have played a key role in the tremendous increase in American agricultural productivity. It is vitally important to insure the future health of the revolving fund and of the cooperative system itself by repairing the damage inflicted by record high commercial interest rates over the past few years.

At the same time, I would like to support the amendment to H.R. 3050 to be offered by my colleague, Congressman Tom Daschle. Those of us who serve rural areas know they have special needs when it comes to providing electric and telephone service. While municipal electric systems serve more than 77 consumers per mile of line, many of the electric cooperatives in my state of North Dakota have only 2 customers per mile. It costs \$1,307 to capitalize a distribution cooperative in a rural area, while it costs only \$648 in an urban area.

Congressman Daschle's amendment recognizes the special needs of low population areas by providing a lower interest rate for cooperatives serving these areas when they have been hit by natural disasters or other financial hardship. Furthermore, the Daschle amendment directs that such loans would be mandatory, not left to the discretion of the Administrator.

It is also important to support this legislation in order to counteract the negative revolving fund proposals just announced by the Reagan Administration. The Administration's measures—a doubling of the interest rate on revolving fund loans to 10 percent; a reduction in the number of loans made by the fund; and a suggestion that the REA look to the private sector for a greater share of its financing—reveal a monumental insensitivity to the importance of the rural electric and telephone systems to our rural citizens.

The dramatic turnaround in population patterns revealed by the 1980 census (which showed a population increase of 15.8 percent in nonmetropolitan areas compared with only 9.8 percent for metropolitan areas) is proof of the continuing importance of rural electric and telephone cooperatives. I strongly support this legislation, with the Daschle amendment, as an important step in maintaining a strong base for our growing rural economy.

Statement by the Honorable Don Fuqua before the Subcommittee on Conservation, Credit, and Rural Development concerning H.R. 3050, the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983.

Mr. Chairman, I appreciate the opportunity to testify in support of H.R. 3050, legislation I have co-sponsored. I want to point out that this bill is co-sponsored by more than one-third of the entire membership of the House.

H.R. 3050 would amend the Rural Electrification Act to provide a sound financial basis for providing reliable and affordable electric service to America's rural and farm areas. The list of co-sponsors includes members from thirty-five states, indicating the recognition of the value and necessity of a viable and growing rural electric program. The commitment of the House is obvious.

The changes proposed by this legislation are endorsed by the National Rural Electric Cooperative Association (NRECA) and the more than 1,000 rural electric systems NRECA represents.

We who represent areas served by cooperatives, and my district is served by several, have come to understand and appreciate the leadership and responsible far-sightedness reflected by NRECA and its members systems and I believe their support for the legislation is extremely important.

Earlier this year NRECA's Committee on Financing for the Future released its report and H.R. 3050 embodies the key recommendations for the future viability of the program.

This is a very important bill to me and the rural electric customers I represent and I pledge to work with your subcommittee to produce the best possible legislation and get it enacted into law.

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STATEMENT OF
HON. JOSEPH M. GAYDOS
OF PENNSYLVANIA

ON H.R. 3050
THE RURAL ELECTRIFICATION AND TELEPHONE
REVOLVING FUND SELF-SUFFICIENCY ACT

BEFORE THE
SUBCOMMITTEE ON
CONSERVATION, CREDIT AND RURAL DEVELOPMENT
OF THE
COMMITTEE ON AGRICULTURE

OCTOBER 4, 1983

MR. CHAIRMAN, I AM HERE TO URGE THE QUICKEST POSSIBLE ACTION ON H.R. 3050, THE RURAL ELECTRIFICATION AND TELEPHONE REVOLVING FUND SELF-SUFFICIENCY ACT.

AS ONE OF 165 CO-SPONSORS IN THE HOUSE OF REPRESENTATIVES -- AND MAYBE MORE BY NOW -- I AM FAMILIAR WITH THE WORK DONE BY OUR RURAL ELECTRIC CO-OPS, AND IF THERE IS ANYTHING IN THE GOVERNMENT THAT ILLUSTRATES THE TERM PUBLIC PURPOSE, THIS IS IT.

THE DELIVERY OF ELECTRICITY RAISED THE LEVEL OF ECONOMIC ACTIVITY AND THE STANDARD OF LIVING IN RURAL WESTERN AND NORTHERN PENNSYLVANIA.

FURTHERMORE, THE CONTINUED MODERNIZATION AND IMPROVEMENT OF THE SYSTEM IS IMPORTANT TO KEEPING UP BOTH THE ECONOMY

AND THE STANDARD OF LIVING; AND THIS IS WHY I AM A CO-SPONSOR OF THE BILL.

THE 13 DISTRIBUTION CO-OPS IN THE PENNSYLVANIA RURAL ELECTRIC ASSOCIATION SERVE ABOUT 600,000 PERSONS AND THEY HAVE PENDING NOW ABOUT \$16 MILLION IN NEEDED IMPROVEMENTS THAT WILL DELIVER BETTER SERVICE. THEY HAVE BEEN UNABLE TO MOVE DUE TO PROBLEMS THE BILL WILL SOLVE.

I READ RECENTLY THAT A FULL RENOVATION OF AMERICA'S INFRASTRUCTURE -- THE THINGS THAT SUPPORT THE ECONOMY AND THE COUNTRY -- COULD TAKE AS MUCH AS \$1 TRILLION UNDER SOME ESTIMATES.

AND, OF COURSE, THE STRENGTH AND SOUNDNESS OF THE INFRASTRUCTURE IS AN IMPORTANT DETERMINANT OF WHAT WILL

HAPPEN AS THIS ECONOMY AND OUR PEOPLE STRUGGLE UNDER DOZENS OF SHOCKS, INCLUDING A TRADE WAR THAT AFFECTS EVEN RURAL AMERICA.

THIS SYSTEM IS AN IMPORTANT PART OF THAT INFRASTRUCTURE, AND IF IT WORKS MORE EFFICIENTLY, IT WILL HELP THE COUNTRY DO THE SAME.

SO THIS IS NO TIME TO BE PERSUADED BY AN ECONOMIC IDEALOGY THAT WOULD HAMSTRING OR DESTROY SOMETHING THAT HAS PROVED THAT IT WORKS AND THAT HAS PROVED ITS WORTH.

ANOTHER PENNSYLVANIA CONGRESSMAN, ONE WITH FAR BETTER JUDGMENT THAN I HAVE, SUMMED UP THE SITUATION IN ONE OF HIS BETTER KNOWN COMMENTS.

AS BENJAMIN FRANKLIN SAID, "KEEP YOUR BUSINESS IN ORDER
AND YOUR BUSINESS WILL KEEP YOU."

H.R. 3050 STEMS FROM THE STUDY AND RECOMMENDATIONS OF
A BLUE RIBBON PANEL THAT INCLUDED THREE FORMER ADMINISTRATORS
OF THE RURAL ELECTRIFICATION ADMINISTRATION. I URGE THE
COMMITTEE TO ACT ON IT FAVORABLY SO OUR CO-OPS CAN GET ABOUT
THEIR BUSINESS.

STATEMENT OF
THE HONORABLE ALBERT GORE, JR
BEFORE THE
SUBCOMMITTEE ON CONSERVATION, CREDIT
AND RURAL DEVELOPMENT
October 4, 1983

Rural electric cooperatives have a unique relationship with and responsibility to their consumers. These consumers have come to expect, and depend upon the co-ops to meet all their electric power needs. The reliability of the power system in rural America is second to none simply because the co-ops have taken their "utility responsibility" very seriously over the years. I believe the people of our nation will continue to expect adequate and reliable service in the future, and depend on the utility industry to do whatever necessary to provide that service.

To carry out their mission, the rural electric cooperatives need credit. Unlike many other businesses, the utility industry's need for new capital entails very little discretion. Utilities build new facilities because they must build them to meet their consumer's needs.

The co-ops borrow from REA for just one reason--to build the facilities needed to provide adequate, reliable service to their consumers. And they will need to borrow in the future to maintain, expand and improve a service which the nation's rural areas cannot do without.

There are some in the present Administration who would like to reduce the size and scope of the REA program by limiting REA financing. This would only serve to increase the cost of borrowing to these non-profit co-ops which must necessarily pass it on to their consumers

in the form of higher monthly electric bills. The electric rates rural consumers must bear, please note, already average 12% higher than those charged to urban and suburban consumers served by other types of utilities. Therefore, cutbacks in the REA program would make this rural-urban inequity more severe while doing no one any good.

H.R. 3050, the "Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983" would restore strength and long-term stability to the REA financing program. It would amend the Rural Electrification Act of 1936 to provide that the interest rate on new REA insured loans, currently fixed by law by 5 percent, would be adjusted periodically to a level adequate to preserve the financial stability of the insured loan revolving fund.

It would also stabilize the existing federal investment in the revolving fund by converting funds appropriated by Congress for loans made prior to 1973 (when the revolving fund was established) into a permanent capital investment in the fund. Currently, REA will be required to repay these funds to the Treasury in annual installments beginning in 1993. Additionally, the bill would allow for increased non-REA financing if demand for funds exceeded the amount authorized by Congress for that year.

H.R. 3050 is a responsible, balanced piece of legislation badly needed by a program that has done an outstanding job in bringing affordable electricity to every corner of this nation. It is also worthy to note that the rural electric program has the best repayment record for any federal lending program in this nation.

Statement by the Honorable Tom Harkin before the Subcommittee on
Conservation, Credit and Rural Development
H.R. 3050
October 4, 1983

Today, nearly fifty years after its creation, the rural electric program is still a strong and vital part of the rural economy and the American economy as a whole. Rural electric cooperatives have given rural Americans access to a reliable, affordable electric energy supply. These cooperatives have played a major role in the advancement of rural America and agriculture production.

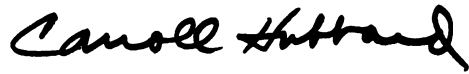
Serving rural areas of this country is a difficult and expensive proposition. For example in Iowa the distribution cooperatives service 171,754 separate meters through a network of 59,658 miles of powerlines. This means cooperatives serve an average of only 2.9 consumers per mile of line. This widely distributed network means high construction and maintenance costs. Iowans know the amount of damage which can be done to this network whether from winter blizzards, spring ice storms or summer rain storms. In order to allow rural areas to continue to be served and to keep electric rates affordable rural electric cooperatives must have a continuing source of long-term financing.

The major source of financing for rural electric cooperatives has been the Rural Electrification Administration (REA) financing program. Through the REA Revolving Fund rural electric and telephone systems have been able to borrow the capital needed to provide service to rural America. However, in the past few years, the Revolving Fund resources have been strained. This has resulted from a combination of high interest rates, and an unanticipated high demand for capital from the Fund due to continued growth in rural areas.

To insure that the future capital needs of the rural electric program will be met, strength and long-term stability must be added to the REA Revolving Fund. This can be done by supporting H.R. 3050 the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983.

The major goal of rural electric cooperatives is to provide an adequate and reliable supply of electric energy at the lowest possible costs. H.R. 3050 is the key to reaching that goal since it would ensure the financial integrity of the Revolving Fund. This legislation is of the utmost importance to the 25-million agricultural and rural area consumer/members being served by and who depend on, rural electric cooperatives. Without the benefits of this legislation, rural electric cooperatives will be forced to obtain capital at higher rates of interest, resulting in higher electric rates for rural consumers. This is an unnecessary burden for them to have to bear.

H.R. 3050 is a positive effort to meet the challenge of the future of the rural electric program, and it deserves the support of my colleagues.



STATEMENT OF
U.S. REP. CARROLL HUBBARD
BEFORE THE
SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT
OF THE
HOUSE COMMITTEE ON AGRICULTURE
OCTOBER 4, 1983

MR. HUBBARD. Mr. Chairman, it is a pleasure for me to have this opportunity to offer my support for H.R. 3050, the Rural Electrification and Telephone Revolving Self-Sufficiency Act of 1983. I cannot stress enough the importance of this legislation to my constituents throughout the twenty-four counties that comprise my Congressional District, the First District of the Commonwealth of Kentucky.

The Rural Electrification program has been in existence for nearly half a century, and Congress has dealt wisely and judiciously in its deliberations concerning this program. I urge my colleagues to follow in this tradition. Indeed, not only is H.R. 3050 important to the residents of western Kentucky, but to the other 25 million agricultural and rural area consumer/members who are served by the electric cooperatives.

Enactment of this bill and its Senate counterpart, S. 1300, would ensure the financial integrity and self-sufficiency of the Rural Electric Administration Revolving Fund. It would also enable the electric cooperative systems to continue their tradition of providing reliable, central station electricity to all rural America.

U.S. Rep. Carroll Hubbard
Page Two Remarks
H.R. 3050
October 4, 1983

As an original cosponsor of the bill, Mr. Chairman, I strongly believe that Congress must help Americans, including Kentuckians, with the ever-increasing costs of utilities. We are keenly aware of the rising costs of electricity. Indeed, all of us hear from our constituents and others about rising electric costs and about the upcoming telephone increases that will be forthcoming in January, 1984, as a result of the recent regulatory decisions and the divestiture of the American Telephone and Telegraph (AT&T).

On behalf of the senior citizens, rural residents and others who have contacted me, please know that I shall continue to work with you to ensure that the people who live in rural areas do not and are not expected to pay more for their electricity. I urge the swift passage and enactment of H.R. 3050.



STATE OF NEBRASKA
ROBERT KERREY • GOVERNOR

October 3, 1983

The Honorable Ed Jones, Chairman
 House Agriculture Subcommittee on
 Conservation, Credit and Rural Development
 108 Cannon House Office Building
 Washington, D.C. 20515

Dear Representative Jones:

I understand that your subcommittee on Conservation, Credit and Rural Development will conduct hearings on October 4-5 on HR3050, concerning the financial solvency of the Rural Electrification Revolving Fund for rural electric and telephone cooperatives. I would like to offer my comments on this bill and explain why I feel the solvency of this program is important to Nebraska and the nation.

Nebraska is a predominantly rural state, and agriculture is our major industry. When the Rural Electrification Act was passed in 1936, rural electric systems became viable in our state. The REA act, which was enacted with the help of a great Nebraskan, George W. Norris, created an administration with the authority to lend as much as \$100 million and also provide technical assistance.

When the REA was created, only about 9,500 or 7.1% of Nebraska farms were receiving central station electric service, mostly from municipal electric system rural lines. As a result of REA's establishment, almost 25,000 farms were receiving rural electric service in 1940, and by 1958 approximately 95,000 or 94.3% of Nebraska farms were being served. Of the first 36 rural electric systems organized in Nebraska, 13 became organized as cooperatives, and seven of those later became rural public power districts.

As you can easily see, the REA has been the major factor in getting electricity to areas where other utilities could not, or would not serve. This has been a critical element in the development of Nebraska's agricultural economy, since much of rural Nebraska is dependent upon rural electric systems. Today, nearly 153,000 rural families, farms ranches, businesses and institutions in this state are served by these systems. In all, approximately 400,000 Nebraska citizens receive their electric service from rural public power districts and electric cooperatives.

Another important factor showing the importance of the REA to Nebraska agriculture is the number of irrigators using electricity. Irrigation development has enabled Nebraska farmers to pursue intensive agricultural production in spite of the state's semi-arid climate, forming a substantial portion of our economic base. In 1980, about one-third of total sales of electricity to farmers was for irrigation purposes.

OFFICE OF THE GOVERNOR, BOX 94848, LINCOLN, NEBRASKA 68509-4848, PHONE (402) 471-2244
 AN EQUAL OPPORTUNITY/AFFIRMATIVE ACTION EMPLOYER

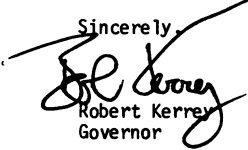
Representative Jones
Page 2
October 3, 1983

The cornerstone of rural electric system financing is the REA Revolving Fund, which makes loans to both rural electric and rural telephone systems. This fund was created to replace the program of 2% loans funded directly by Congressional appropriations. Beginning in 1976, a net outflow of dollars from the fund began to occur, causing concern about cash flow. In order to supplement the fund through this period, Congress established Certificates of Beneficial Ownership, or CBOs, issued by the U.S. Treasury at interest cost plus one-eighth of one percent.

Due to excessively high interest rates in recent years, the interest expense on the CBOs has greatly exceeded incoming funds, a trend that is moving the Revolving Fund ever closer to insolvency. This is a great concern to me, because the REA Revolving Fund is a vital and necessary program for Nebraska and other agricultural states. Our economic well-being depends on the activities in rural Nebraska, which in turn depend on a reliable and reasonably priced supply of electricity.

In the interest of rural America, I encourage you to support the concepts embodied in HR3050. It is vital to Nebraska and states like it that our rural electric systems remain viable.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert Kerrey", written over a horizontal line.

Robert Kerrey
Governor

RK:rad



**NATIONAL
FARMERS
UNION**

STATEMENT OF

**ROBERT J. MULLINS
DIRECTOR
LEGISLATIVE SERVICES
NATIONAL FARMERS UNION**

SUBMITTED TO THE

**SUBCOMMITTEE ON CONSERVATION, CREDIT
AND RURAL DEVELOPMENT**

**COMMITTEE ON AGRICULTURE
U.S. HOUSE OF REPRESENTATIVES**

REGARDING

H.R. 3050

**"RURAL ELECTRIFICATION AND TELEPHONE REVOLVING FUND
SELF-SUFFICIENCY ACT"**

**October 4, 1983
Washington, D.C.**

Mr. Chairman and Members of the Subcommittee:

I am Robert J. Mullins, Director of Legislative Services for the National Farmers Union. On behalf of the farmer and rancher members of the National Farmers Union, I appreciate the opportunity to lend the support of the Farmers Union to H.R. 3050, the "Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act." As you know, Mr. Chairman, we in the Farmers Union have been long-time supporters of the Rural Electric and Telephone Systems since a vast majority of our members rely upon these member-owned cooperatives for their electric and telephone services. We believe the legislation embodied in H.R. 3050 will allow these cooperatives to continue, in an economically secure manner, their services to rural America.

One hour of farm labor today produces 14 times as much food and other products as it did 60 years ago.

Certainly, intensive and continuing research accounts for a good share of this spectacular boost in fundamental productivity. But it is clear also that the increase owes much to the fantastic improvement in the efficiency of the American farmer during this time.

And it surely is not coincidental that these 60 years fairly well duplicate the development of a rural electrification program that has added the hum of electric power to the sweat and muscle of man.

It is not possible to measure precisely what this has meant to all of us in this country, but it is possible to measure some things here and there.

Simply as examples, let me point to these: Today's agriculture in the United States is the largest commercial industry in the world, providing jobs for 23 million people, more than one-fifth of our total labor force; food costs now take less than 17% of our average disposable income, a strikingly modest figure compared to the 60% to 70% required for the same purpose in some countries.

Much more could be said about the remarkable gains in agricultural productivity in this country, and what these gains have meant in dollars and cents, in healthful comfort and security, to all of us. This should be sufficient, however, to emphasize the need for maintaining this abundance, the farm system that has produced it, and the dependable source of power that has helped so mightily to advance both to where they stand today.

These are the concerns that move us without hesitation to offer full support for the proposals of America's rural electric cooperatives, as embodied in the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act.

Cognizant of the need for a strong rural electrification and telephone system in this country, the delegates to the last national convention of the Farmers Union adopted the following statement relative to rural electrification and telephone service:

"M. Rural Electrification and Telephone

"The establishment of federally sponsored rural electrification and rural telephone cooperative systems not only helped American agriculture increase its productive capacity, but also generated demand for goods and services that spurred production and employment across the nation.

"The ability of these cooperatives to continue supplying reliable and affordable services to farms and other sparsely populated areas of the nation hinges on their ability to acquire adequate capital.

"The revolving fund and loan guarantee programs made available to electric cooperatives by the Rural Electrification Administration (REA) and the low interest loans and guarantee programs available for rural telephone service

have proven to be effective and efficient means of meeting these financing needs. Revolving funds and loan guarantee programs are available at no cost to the American taxpayer.

"National Farmers Union supports continuation of strong rural electrification and telephone programs and urges the Congress to preserve and continue the financing now available through REA and the Rural Telephone Association. We ask Congress to authorize funding levels to be made available through these programs, adequate to meet the capital requirements of rural electric and telephone systems."

The start of the 60-year period I have referred to saw almost all of the rural areas of this country without electric power, and without it there was no prospect at all of a powered agriculture and all of the benefits we have seen it produce.

We know very well the story of how electrification finally came to the back roads of this country, and we know just as well that the form in which it came -- user-owned and -controlled, nonprofit cooperatives -- had everything to say about its dependability and economy throughout the past half-century.

Progressive agriculture needed that steady assurance that its new electric service would be fully reliable and that it would be as economical as it was possible to make it across the thinly-populated areas of rural America. It was understood then as now that these necessary conditions had their best possibility of achievement through people-owned organizations which had no need or incentive to sell electricity for any reason other than to serve themselves.

Rural electrification in this country, through all of the last 50 years, has grown hand-in-hand with our growing agriculture. As farm and other rural needs for electric service have grown, the user-owned rural electric systems have grown steadily to meet those new needs.

In our view, it is vital to preserve this reliability, this continuing assurance that our concerns are their concerns.

We know that rural electric cooperatives, like all electric utilities of every sort, always will have need for access to capital on the best possible terms. The Rural Electrification Administration's revolving fund has met these needs well and can continue to do so if it is protected from a continuing imbalance between interest income and outgo. We endorse H.R. 3050 as a sound means to this end.

STATEMENT OF THE NATIONAL FARM COALITION
BEFORE THE
SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT
HOUSE AGRICULTURE COMMITTEE

HEARINGS ON H.R. 3050
THE RURAL ELECTRIFICATION AND TELEPHONE
REVOLVING FUND SELF-SUFFICIENCY ACT OF 1983

The National Farm Coalition, a nationwide network representing agricultural and farm groups stands in support of H.R. 3050, legislation designed ensure the long-term strength and viability of the rural electrification program.

This nation's agricultural industries are highly energy intensive. As farmers and ranchers we are acutely aware of the critical interdependence between this nation's agricultural productivity and the need for adequate supplies and dependable sources of energy. The creation of the rural electric cooperative program, nearly a half-century ago, was to epitomize one of the most successful partnerships to form between this government and its citizens. Since its creation, the rural electrification program has provided nothing less than a reliable, dependable central-station electric service to all of Rural America.

The numerous benefits that electrification has brought to rural America -- creating jobs, in alleviating the drudgery that consumed many farmers' waking hours, in enhancing rural life, in contributing to the most productive agricultural economy in the world -- more than outweigh the relatively small costs of the program. However if rural electric cooperatives are to continue their contributions to rural America and are to meet our energy needs for the future, it is vital that they also have access to the capital that is required to build and operate power plants, distribute the electricity and to maintain their lines.

We must recognize also the very significant role rural electric cooperatives play in reducing this nation's dependence on foreign oil, particularly if this country is to achieve energy independence for the future. As the Honorable Mark Andrews, a Senator representing one of the most agrarian and most sparsely populated areas in the nation, states so aptly:

We rely on imported petroleum for 15 percent of our energy, about the same share as 10 years ago. Reducing this dangerous dependency and creating an assured energy supply are vital national goals and rural electric cooperatives can help. If co-ops have access to the capital that is required to build power plant and deliver the electricity that this country needs, they can play a major part in reducing foreign oil with home-grown fuels such as coal.

The National Farm Coalition is unified in its commitment to assure that this nation's agricultural economy and productivity remain the strongest in the world. We stand united also in our belief that a key aspect toward maintaining the strength of our agricultural industries lies in the concomitant strength of the rural electric cooperative sector.

American Agriculture Movement

Cenex

Communicating for Agriculture

Cooperative League of the USA

Land O'Lakes

Midcontinent Farmers Association

National Association of Farmer Elected Committeemen

National Association of Wheat Growers

National Farmers Organization

National Grange

National Milk Producers Federation

National Rice Growers Association

National Rural Electric Co-Op Association

Peanut Group

Sugar Group

W.I.F.E. (Women Involved in Farm Economics)

TESTIMONY ON H.R. 3050

Submitted to the
SUBCOMMITTEE ON CONSERVATION,
CREDIT, AND RURAL DEVELOPMENT

By the

HON. LINDSAY THOMAS
MEMBER OF CONGRESS

Mr. Chairman, I thank you for the opportunity to testify before you and your colleagues on the subcommittee on Conservation, Credit, and Rural Development concerning a piece of legislation so vital to our nation's rural communities: H.R. 3050, The Rural Electrification and Telephone Revolving Self-Sufficiency Act of 1983. I am pleased to co-sponsor this legislation, with many others, including the chairman and ranking minority member of this committee.

I am privileged to represent the First Congressional District of Georgia, a district comprised in large measure by a number of small rural, farming communities. Without the formation of rural electric and telephone cooperatives much of my district might today not have these essential services. I, myself, grew up in a small community that did not have electricity when I was a young boy. I can personally attest to the great impact that these electric and telephone cooperatives have made upon rural America.

In 1935 when the Rural Electrification Act was passed, less than two percent of Georgia's farms had electricity as compared with over ninety-nine percent today. Presently, rural electric

systems serve nearly 2,250,000 consumers in Georgia. The rural telephone cooperative supply services to 1,816 business and 17,645 residential subscribers in Georgia. Currently forty-five electric and telephone cooperatives in Georgia borrow money from the revolving fund. As these figures indicate, Mr. Chairman, rural electric and telephone cooperatives continue to play a vital role in rural Georgia and rural America.

Since the passage of The Rural Electrification Act in 1935, Congress, most administrations, and the leadership of the REA have worked closely together to ensure the continuation of this indispensable program. The challenge that confronts us today is to maintain the financial integrity of the revolving fund that provides the financing system for these cooperatives. Without question, rural America will continue to need adequate, reliable electric and telephone services - services that only these cooperative utilities can supply. However, these cooperatives must likewise have a dependable, solvent revolving fund to provide them the monies needed to finance expansion and maintenance operations. We must be mindful that the absence of this fiscally solvent fund will, at the very least, mean higher utility rates for our farming communities and at the worst, the end of reliable utility services to rural America.

I believe that this committee and the leadership of the REA should be commended for their foresight in recognizing this potential danger and moving to blunt it. Far too often in our country, we have ignored problems until they have reached crisis proportions. Then, we have been forced, in the midst of that crisis, to take inappropriate corrective measures without the benefit of adequate

study. I hope that the administration and critics of H.R. 3050 will take into consideration that this subcommittee's efforts are directed toward averting this type of situation. While the revolving fund that finances the REA cooperatives is not currently insolvent, future demands upon it will place undue strains upon the fund unless additional capitalization is provided.

H.R. 3050 supplies the needed dollars. It does so in an orderly, timely, and fair manner. I pledge my continued efforts to see final passage of this valuable legislation and urge my colleagues in Congress to join me in this effort.

Testimony

of

Representative Vin Weber

I am pleased to have the opportunity to testify today. I join my colleagues in support of H.R. 3050, a bill to amend the Rural Electrification Act of 1936 to ensure the continued financial integrity of the Rural Electrification and Telephone Revolving Fund.

It is heartening to have hearings on this issue during "co-op month". I hope these hearings will result in swift passage on H.R. 3050, and I pledge to do whatever is necessary to get this bill enacted into law.

The Second District in Minnesota is proud to be dominated by rural telephone and electric cooperatives. Some argue that my District was built on the strength of the cooperative. I believe that to be true. But more importantly, I believe the strength of rural America can be traced directly to the development of electrical and telephone cooperatives.

Mr. Chairman, as you know, the last major amendment to the Rural Electrification Act was passed by Congress and signed into law over 10 years ago -- May, 1973. Since then, thousands of people have returned to rural America reversing years of decline. They've returned because rural America is an attractive place to raise a family and seek out new opportunities. Without an adequate supply of electric power, at reasonable prices, these opportunities would not be available. Rural America will continue to offer economic opportunities, but not without a strong and viable rural electric loan program. The changes that are being suggested in H.R. 3050 are modest but significant to the future of the Rural Electric Program. We all recognize that the revolving fund, from which 15% of the total capital is obtained needs corrective action in order to continue to be a viable source of funds for cooperatives. The cooperatives, which own nearly 50% of all distribution electric lines in the United States, are supporting the proposed increase in loan rates from the revolving fund. With periodic adjustments, enough to keep the fund in balance, and

with the systems re-paying every dime loaned to them, I believe that we can expect a continued strengthening of the rural economy. I must add, the rural electric payment record is unsurpassed. Rural cooperatives have taken the lead in opting for legislation which will make their program financially secure, yet not at the cost to the taxpayers. Most groups come before the Congress and simply ask for increased federal spending or subsidization. Not the cooperatives. They search for methods to "get a bigger bang" for the program, without asking for hand-outs. It is refreshing to support this legislation for that reason alone.

I am pleased to join my colleagues in urging adoption of this proposal, early consideration by the full committee, and by the House of Representatives.

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STATEMENT OF THE HONORABLE PAT WILLIAMS
BEFORE THE AGRICULTURE COMMITTEE
SUBCOMMITTEE ON CONSERVATION, CREDIT AND
RURAL DEVELOPMENT
OCTOBER 4, 1983

As an original cosponsor of this bill, I am pleased to have this opportunity to present testimony in favor of HR 3050, the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983.

Since 1935, the Rural Electrification Administration has been providing loans to rural electric cooperatives and rural telephone cooperatives so that America's farmers and ranchers would be able to have electricity and telephone service. The federal government made a commitment to ensuring universal electric and telephone service to all Americans, regardless of whether they lived in the city or in the country. In Montana, where many miles separate small communities and often farm and ranch neighbors, the REA has been indispensable in helping co-ops provide adequate electric and telephone service.

Unfortunately, the present Administration believes that the REA has outlived its usefulness. In fact, the Administration has indicated that those who live out in the country are simply going to have to pay more for electricity and telephone.

THIS STATIONERY PRINTED ON PAPER MADE WITH RECYCLED FIBERS

The Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act would keep the REA alive and well. It would ensure that all Americans, not just those who live in large cities, will have access to electricity and telephone service. I am confident that the committee will act favorably on this important piece of legislation.

RURAL ELECTRIFICATION AND TELEPHONE REVOLVING FUND SELF-SUFFICIENCY ACT OF 1983

WEDNESDAY, OCTOBER 5, 1983

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSERVATION, CREDIT,
AND RURAL DEVELOPMENT,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:10 a.m., in room 1302, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives English, Glickman, Daschle, Stenholm, Tallon, Durbin, Evans of Illinois, Coleman, Skeen, and Gunderson.

Also present: Representative Albosta.

Staff present: Robert M. Bor, chief counsel; Robert T. Lowerre, associate counsel; John E. Hogan, minority counsel; Mark Dungan, minority associate counsel; Peggy L. Pecore, clerk; Robert A. Cash-dollar, James W. Johnson, Jr., Bernard Brenner, Gerald W. Welcome, and David A. Ebersole.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. JONES of Tennessee. The Subcommittee on Conservation, Credit, and Rural Development will resume its sitting from yesterday's meeting.

Good morning to all of you who are here this morning, witnesses as well as those who are here to listen.

We have a nice group of witnesses this morning, and we would like to move as fast as possible. We will use the same rules today that we used yesterday. I thought that we moved very rapidly and very fairly in yesterday's hearings.

If we do conclude by noon today, there is some good possibility that we might markup this bill in the afternoon. That seems to be the wish of the majority of the members of this subcommittee and of the chairman of the full committee.

The first witness this morning is the Honorable Don Albosta, a Member of Congress from the State of Michigan. I do not believe he is in the room.

Therefore, I will call the first panel. The first panel consists of Mr. Robert D. Partridge, executive vice president of the National Rural Electric Cooperative Association, commonly known as NRECA, here in Washington; Mr. Guy C. Lewis, Jr., Rappahannock

Electric Cooperative, Bowling Green, Va., president, NRECA; Mr. James A. Vann, Jr., Dixie Electric Cooperative, Union Springs, Ala., president of the Cooperative Finance Corp.

Gentlemen, we are delighted that you are here.

I believe that Mr. Lewis is going to begin. You may handle it any way that you wish, Mr. Lewis and members of the panel.

STATEMENT OF GUY C. LEWIS, JR., PRESIDENT, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION AND MANAGER, RAPPAHANNOCK ELECTRIC COOPERATIVE

Mr. LEWIS. Thank you.

Chairman Jones and other distinguished members of the Subcommittee on Conservation, Credit, and Rural Development, my name is Guy C. Lewis, Jr. I am a resident of Bowling Green, Va., where I manage the Rappahannock Electric Cooperative, a consumer-owned and controlled utility system which provides electric service to about 41,000 members in rural Virginia. In addition, it is my honor and privilege to serve as president of the National Rural Electric Cooperative Association, the voluntary service organization of the Nation's some 1,000 rural electric systems, which deliver electric energy to some 25 million Americans in 46 States.

Mr. Chairman, I am most pleased to have the opportunity to present my views on H.R. 3050, the Rural Electric and Telephone Revolving Fund Self-Sufficiency Act of 1983.

Because the availability and cost of capital is of such crucial importance to the future of the rural electrification program, it is only natural that over the years this subject has been a very major concern to our national association, and to the thousands of rural electric system directors and managers who know that adequate and affordable loan funds are the lifeblood of the rural electrification program.

This subject has been of special concern to me personally since the fall of 1981, when my immediate predecessor as NRECA president, Angus Hastings of Florida, asked me to serve as chairman of a special NRECA Committee on Financing for the Future.

This committee consisted of 17 outstanding leaders, representing every region of the Nation and every segment of the rural electric program. It also benefited greatly from the ex officio participation of three former Administrators of the Rural Electrification Administration, Norman Clapp, David Hamil, and Robert Feragen, along with the present governor of the National Rural Utilities Cooperative Finance Corporation, Charles Gill.

The committee spent more than a year examining virtually every aspect of rural electric financing, including, of course, a thorough examination of the Rural Electric and Telephone Revolving Fund, the mechanism created by Congress in 1973 to be the source of capital for REA insured loans.

Through a series of open meetings with our members, and consultation with experts from the financial community and elsewhere, we tapped into the best thinking available on every aspect of our financing future.

We knew even before the committee began its work, however, that the combined effect of extremely high interest rates in the

past few years, along with continuing heavy demand for loans by REA borrowers, had put strains on the Revolving Fund far greater than was anticipated at the time of its creation.

For this reason, we spent a considerable amount of time working, not only to fully explore and define the problems facing the Revolving Fund, but also seeking ways in which the Fund could be permanently restored to financial strength and stability.

From the very outset of this effort, we strongly felt—and still believe—that the REA borrowers themselves, working through their national organization, must take a lead role in creating a workable plan to preserve an adequate and affordable financing program. This is consistent, I believe, with the reputation the rural electric have worked hard to build as a group ready and willing to assume responsibility for its own destiny, and one that comes to Congress not just with problems, but also with fair and reasonable solutions that make good sense for the rural electric and for the Nation as a whole.

Mr. Chairman, it is not my intent to review at this time the full set of recommendations that are the result of the work done by NRECA's Committee on Financing for the Future. To a very great extent, these recommendations are embodied in the legislation before you today, the main provisions of which will be discussed by others scheduled to appear at this hearing.

I think it's important to note, however, that the recommendations of our study committee have been thoroughly evaluated by the full membership of NRECA. The major changes in REA lending policy and practice we have suggested—and which would be implemented through enactment of H.R. 3050—were discussed at length and unanimously endorsed by the delegates to our 41st annual meeting earlier this year.

We have taken great pains to insure that the NRECA membership is fully aware of all the implications of what is being proposed in H.R. 3050, including the fact that it will very likely result in an increase in the interest rate charged on REA insured loans. Our members, nonetheless, believe that this is the proper course for us to pursue at this time, and that the long-term future interests of the rural electric systems and their member consumers are best served by accepting an increase in the cost of borrowing today.

We firmly believe that this plan is both reasonable and responsible.

It will establish a self-correcting mechanism for REA interest rates that, if implemented in accord with the spirit and intent behind its creation, will insure that the Revolving Fund will be able to continue for many years in its vital role as a capital source for rural electrification.

It will provide a means by which rural electric borrowers can, at a controlled and orderly pace, continue to evolve toward greater reliance on private lenders to supplement capital borrowed through REA. It will facilitate this movement to the private market by improving the terms under which REA will share its mortgages with other lenders.

It will maintain the present level of Federal investment in rural electrification by keeping the assets Congress put into the Revolving Fund in 1973 as part of the Fund for as long as they are

needed. Under present law, this initial capitalization of the Fund will be gradually siphoned off, beginning in 1993.

Most important, however, is the fact that the proposals contained in H.R. 3050 will help insure the continuing fulfillment of a promise made by our Government to the people of rural America nearly 50 years ago: That the comfort, convenience, and increased productivity made possible by central station electric service would no longer be reserved only for people in the cities and towns of our Nation.

America's independent, consumer-owned rural electric systems have done their part to make the dream of universal, area coverage electric service a reality. And even though we've come a long way, we still face many of the same challenges that existed in 1935, including low-consumer density, difficult terrain, and high cost of power.

There's no question that we needed the assistance provided by REA to get the rural electrification program started in the thirties and forties. It's just as clear, I believe, that we will continue to need a strong REA for as long as rural electrics operate largely in areas other utilities could not—or would not—serve.

Mr. Chairman, I truly appreciate this opportunity to appear before this distinguished panel. On behalf of myself, NRECA, and the 25 million men, women, and children of our Nation who depend on REA-financed systems to keep the lights on and the power flowing across rural America, I hope you will give prompt and favorable consideration to H.R. 3050.

I will be happy to answer any questions that I can.

Mr. JONES of Tennessee. Thank you very much, Mr. Lewis, for a very good statement. We do appreciate the time that you have taken to be here with us today. The questioning period will be later.

Our next witness is a familiar face around here for a long, long time, Mr. Robert D. Partridge, executive vice president of the National Rural Electric Cooperative Association, commonly known as NRECA, here in Washington.

Bob, it is delightful to have you with us. You may proceed.

STATEMENT OF ROBERT D. PARTRIDGE, EXECUTIVE VICE PRESIDENT, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Mr. PARTRIDGE. Thank you, Mr. Chairman and members of the subcommittee.

If I may have my full statement inserted in the record, I will attempt to summarize the statement which I have to make.

Mr. JONES of Tennessee. Without objection, the entire statement will become part of the record if you summarize.

Mr. PARTRIDGE. My name is Robert D. Partridge. I am executive vice president and general manager of the National Rural Electric Cooperative Association, the trade association which represents some 1,000 rural electric systems in 46 States, serving nearly 25 million Americans.

First, let me express our very strong support throughout the rural electrification program for H.R. 3050, the legislation which

this hearing addresses. This is legislation which we think is vital to the viability of the REA loans programs and of the rural electrification program itself.

This bill and the companion bill in the Senate, which is S. 1300, are designed to insure the continued stability and solvency of the Rural Electric and Telephone Revolving Fund administered by REA in carrying out the insured loan program of that agency.

The Revolving Fund was created by Congress in 1973 to expedite rural electric and telephone financing in the absence of annual appropriations which had been terminated in December 1972.

That Fund has served its purpose well. However, due to economic conditions that could not be anticipated at the time Congress created the present loan program, primarily inflation, which caused a much heavier flow of cash out of the Revolving Fund than we had anticipated might be needed, coupled with sky-high interest rates of the period from 1979 through 1982, it has come to the point that we must now make some adjustments in the mechanics of the operation of the Revolving Fund.

The major provision of H.R. 3050 gives REA the authority to insure balance in the Revolving Fund—in fact, mandates that the Administrator will maintain that balance—through periodic adjustments in the interest rates. That will, of course, mean higher borrowing costs to rural electric and telephone borrowers, but we believe that the higher cost interest expense is worth it to stabilize the Fund and to assure its continued solvency into the years ahead.

Interest applied to new REA loans, which is now fixed by law at 5 percent, will be periodically adjusted to a rate high enough to preserve the financial balance of the Revolving Fund.

The bill also contains language that would have the effect of mandating that the supplemental loan ratios and criteria now applied in REA loans be used only in a positive way, primarily as a method to insure that available loan funds will be evenly distributed to all qualified borrowers. That will provide many low-equity cooperatives with continued access to the Revolving Fund.

It will also prevent the use of these ratios as a means of artificially depressing REA lending activity, and by so doing, falsely justify severe reductions in the loan levels. The present requirement that loans be arranged with 30 percent non-REA funds is already very difficult for many cooperatives, and certainly the 50-50 ratios that the Administration has talked about on many occasions would pose a real hardship on many of the rural electric and telephone systems.

Another important part of the overall proposal calls for Congress to capitalize the funds in the Revolving Fund, as was brought out in testimony yesterday, into a permanentizing of the capital, rather than having it exist as debt, as it now does on the books of the Government. That is a principal and cardinal feature of the plan.

Under present law REA will be required to pay the notes coming due beginning in 1993 and thereafter through the year 2017, notes given to the Treasury to obtain the funds for the direct loan program, which was carried out by REA in 1972 and prior years.

We think that the present requirement under the act as it now is, and without the amendments proposed by this bill, which is that the funds would go back to the Treasury, would be of no real bene-

fit whatsoever to the public, and that it would very significantly add to the cost of providing electric service in rural areas of this country.

The net impact on the Federal budget of sending this money back to the General Fund of the Treasury, rather than retaining it in the Revolving Fund, will be essentially a wash, if it occurs, since making those payments will clearly increase the Revolving Fund's need for new borrowings from the Treasury by a corresponding amount.

Let me make it quite clear that nothing in the proposed legislation would result in the forgiveness of the indebtedness of any borrower of REA, despite some of the media comments to the contrary.

As this committee very well knows, both the Revolving Fund and the Treasury are the property of the U.S. Government and will remain so under the provisions of the amendments to this act.

The legislation would not in any way reduce the principal or interest payments due on any loan made by REA to rural electric or telephone borrowers. Not one dime of that lending would be forgiven under the provisions of this bill.

One of the important features of the legislative package is a mechanism for helping systems which have to provide service under unusually difficult circumstances. There is strong justification for giving special consideration to the relatively few systems that operate under extreme hardship, as Chairman de la Garza noted yesterday, due to the topography of the areas that they serve, sometimes due to storm damage or other natural disasters, and due to the financial condition of their consumers.

For these reasons, we are supporting language in the bill calling for a special interest rate program with appropriate qualifying criteria, carrying an interest rate of no less than 2 percent and not more than one-half of the prevailing REA interest rate at any given point in time.

There are a number of other important features of the proposed bill, and these are going to be discussed, I am sure, in the testimony to be given the committee this morning by former REA Administrators Norman Clapp and Robert Feragen and CFC Governor Chuck Gill.

Both H.R. 3050 and S. 1300 have come under very strong administration-inspired attack, and I suspect that there will be much more of that kind of criticism by the time these bills reach the floor of the respective Houses.

The point I would like to make here is that we are only asking for fairness and for recognition of the difficult job that rural electric cooperative people around the Nation are carrying out. The task that they have is difficult in trying to provide reliable and affordable electric service to rural America under today's costs and other factors that impact upward on rates.

We have many problems servicing low-density areas and dealing with unfavorable terrain and other conditions that are not faced by urban utility systems. We certainly do not need—we cannot really endure—additional obstacles put into our collective paths in trying to keep on with the job of providing service that is dependable and acceptable in terms of rates.

As opposed to the very modest assistance that rural electric receive for serving the most remote areas of this country, other segments of the utility industry receive many times more Federal assistance. Let me emphasize that we do not complain about that. We understand the need for that. We have supported the need of both the investor-owned companies and the public systems for the kind of assistance which they have, assistance which is about five times, on a per meter basis, the assistance afforded the rural electric cooperatives under the REA program.

I very strongly believe that enactment of the bill now pending before this subcommittee will be in the best interest of the consumers of rural electric cooperatives and the citizens of this entire country.

Thank you very much.

Mr. JONES of Tennessee. Thank you very much, Mr. Partridge, for a very fine statement. We appreciate your presence and your help here with our testimony.

The next witness is Mr. James A. Vann, Jr., Dixie Electric Cooperative, Union Springs, Ala., and president of the Cooperative Finance Corp.

Mr. Vann, welcome. We are delighted to have you here.

You may proceed.

STATEMENT OF JAMES A. VANN, JR., GENERAL MANAGER, DIXIE ELECTRIC COOPERATIVE AND PRESIDENT, NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP.

Mr. VANN. Thank you, Mr. Chairman.

I, too, have prepared a statement, which has been filed with your subcommittee, and I request that it be made part of the record and that I be permitted to give the subcommittee a brief summary.

Mr. JONES of Tennessee. Without objection.

Mr. VANN. Thank you.

Before I proceed with the summary, I would like to make one comment, if I might, about the passing of one of my fellow CFC directors from district 3, Walter S. Nunnely. Walter was from Merriweather Lewis Electric Cooperative of Summitville, Tenn., and was a long-time friend of Chairman Jones. He was a strong supporter of the rural electric program. We will miss him and his wise counsel.

CFC is owned by 928 members, including 806 rural electric distribution systems, 60 power supply systems, 60 State, regional, and national service organizations, and two associate members.

CFC was incorporated in April 1969 for the purpose of providing its members with a source of long-term and short-term financing to supplement their borrowings from the Rural Electrification Administration. The recommendations to create CFC were a part of the final report of the long-range study committee which was appointed in 1967 by NRECA.

The first long-term loan made by CFC, concurrent with loans from REA, was made in 1971. Since 1971, when CFC began its lending operation, it has continued to add the types of programs and services to provide to its members better service.

In November 1981 the CFC board, in recognition of the values and the importance of periodically reexamining the role of the organizations in the rural electric program, authorized establishment of a Committee on Objectives and Planning. The committee held numerous meetings, undertook studies on future capital requirements for the distribution in the power supply systems through the end of this century.

During 1982, the committee worked very closely with NRECA's Committee on Financing for the Future, holding several joint meetings around the country with rural electric leaders and sharing data and information.

The CFC committee presented its report to the CFC membership earlier this year. The members endorsed all of the recommendations, and the CFC board is now engaged in developing and approving policies and procedures to implement these recommendations.

One important recommendation made by the committee calls for amendment of the Rural Electrification Act to clarify the authority of the REA Administrator to provide private lenders with marketable security for loans they make to REA borrowers. Section 7 of H.R. 3050 proposes to amend section 306 of the Rural Electrification Act to implement that recommendation. Governor Gill, the chief executive officer for CFC, later this morning will discuss the significance and importance of this provision in more detail.

CFC also endorses the other provisions of H.R. 3050 to amend the Rural Electrification Act, particularly those which will assure the continued viability of the Rural Electric and Telephone Revolving Fund.

Mr. Chairman, on behalf of the CFC board of directors and its members, we thank you for the opportunity to present our views.

[The prepared statement of Mr. Vann appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Vann. We appreciate the fact that you are here and your statement and interest.

Gentlemen, if you can remain, we would be glad for you to do so and be questioned at a little later time.

Does Mr. Smith have any type of statement?

Mr. PARTRIDGE. No, Mr. Chairman. Don Smith, our chief economist, accompanied us to the table and will be with us during the questioning period.

Mr. JONES of Tennessee. All right. We will hear the next panel, then, and then we will call all the panels back together.

Our next panel is made up of former REA Administrators. We are delighted, indeed, to see Norman Clapp here, Robert Feragen. We are sorry, indeed, that David Hamil could not make it. Dave is probably the most familiar figure that has been around here for a long, long time. Sitting in for him today is John Davenport, of NRECA, who will present Dave's testimony.

Norman, inasmuch as you are the senior member of the group out there as far as time with REA is concerned, I believe that we will hear you first.

Mr. Norman Clapp, of Alexandria, Va., is a former REA Administrator.

We are delighted that you are here.

**STATEMENT OF NORMAN M. CLAPP, FORMER ADMINISTRATOR,
RURAL ELECTRIFICATION ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE**

Mr. CLAPP. Thank you, Mr. Chairman and members of the committee.

I would like, just for the record, to identify myself as Norman Clapp. I have, until recently, been engaged in the consulting business, in which I have had an opportunity to keep in touch with the progress and the problems of the rural electrification program. Presently, I am completely retired, except that I continue to sit on the board of directors of the Stone Webster Power Projects Corp., and I try to keep posted on this program.

I do have a prepared statement which, if it suits the pleasure of the subcommittee, Mr. Chairman, I would like to submit for inclusion in the record at the close of my oral remarks.

Mr. JONES of Tennessee. Without objection, the entire statement will become part of the record, and you may summarize as you wish.

Mr. CLAPP. Mr. Chairman, members of the subcommittee, I am appearing here today in full support of this legislation you have for consideration, H.R. 3050.

I believe, as a former Administrator in this program, that the legislation is urgently needed, if we are going to counter the disastrous effects of recent and even current interest rates on the REA program and the ability of the program to accomplish its mission in future years.

Historically, as this committee well knows, the purpose of the rural electrification program and its assistance to the electric cooperative systems across the country has been to close the gap between the availability and the affordability of electric service in rural areas as compared to the urban-based areas.

We have made tremendous progress in past years in accomplishing or toward accomplishing that objective, but the experience of the last decade has cast a very serious shadow on the ability of these systems to continue to do the job that they were established to do.

The decade has been difficult for the entire electric industry. It has been particularly difficult for the rural electric systems, because they have had to step into the breach and shoulder a greater percentage of their wholesale power needs at a time when costs were rising tremendously and when the cost of capital, as represented by the interest rates that they must pay, has risen dramatically.

This has put an unusually heavy burden upon not only the power supply cooperatives, but also the distribution co-ops to which they sell their power. The result has been that after years of closing this gap between the affordability of electric service in rural areas as compared to urban areas, now we are moving through a period in which that gap shows every promise of opening up again.

Retail rates are going up. They are going up faster in the rural segment than they are in the industry generally. This is due in large measure to the effect of the increased wholesale power costs.

Interest rates are really eating this program up. It is having the obvious effects upon the Revolving Fund, which is the source of credit for the distribution co-ops, and it is having an even accelerated effect, through the guaranteed program, on the costs facing the generation and transmission cooperatives.

Therefore, this legislation, which attempts, and I believe very constructively does, to deal with the availability, the future availability, and the future affordability of capital for the rural electric program, is extremely urgent and needs to be enacted.

With that, Mr. Chairman, I would like to submit my prepared statement for inclusion in the record, with one note of correction. On page 3 of the statement, in the third paragraph, the 15,000 kilowatts, as appears there, should read 15,000 megawatts.

Thank you very much, Mr. Chairman, for the opportunity to appear before this subcommittee.

[The prepared statement of Mr. Clapp appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Norman, for a very good statement. We shall look forward to reading the entire statement, as time will permit.

We appreciate the contribution that you have made to REA in both the electric and telephony departments of REA. You deserve a lot of credit for the good job that you have done through the years. In fact, you are a young man to be retiring.

Now Mr. Robert Feragen of the East River Electric Power Cooperative, Madison, S. Dak., a former REA Administrator, is our next witness.

Mr. Feragen, we are delighted to have you here with us today. Welcome back.

STATEMENT OF ROBERT W. FERAGEN, MANAGER, ADMINISTRATIVE SERVICES DIVISION, EAST RIVER ELECTRIC POWER CO-OPERATIVE, AND FORMER ADMINISTRATOR, RURAL ELECTRIFICATION ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE

Mr. FERAGEN. Thank you, Mr. Chairman. I appreciate that very much.

I have prepared a statement, which the committee has. I would ask that it be made part of the record.

Mr. JONES of Tennessee. Without objection, it will be made a part of the record, and you may summarize as you please.

Mr. FERAGEN. I would like to do that, Mr. Chairman.

I was honored to be a part of the committee that studied the financial needs in the future for the NRECA and its members. I am quite familiar with the provisions of H.R. 3050, and I believe that they do and will solve a problem that will be extremely serious if these changes are not made with respect to the Revolving Fund.

I would like to make just one observation, Mr. Chairman. I believe that one thing that this committee should consider is that, if the Revolving Fund does, in fact, dwindle away, the relationship between the rural electric systems and Congress will also dwindle away.

I am sure this is true of all rural electric systems, but it is certainly true of those in my part of the country—that it has been a good partnership between the rural electric systems and Members of Congress with both political parties. We have had the kind of support and understanding of what is needed in rural America. My statement talks about that, and I would like to stress that, because we have found an understanding of what it takes to do rural electrification among Members of Congress and have gotten support over the years.

Therefore, I, of course, am strongly urging the passage of H.R. 3050, and I would like to point one fact that sometimes gets muddled. That is the idea that because distribution systems are eligible for part of their loan needs from 5 percent Revolving Fund loans that they are somehow avoiding interest costs. I would like, as my statement does, to point out that the real interest costs are borne in the wholesale power supply bills that are paid by those systems.

In the Missouri Basin we have three tiers of cooperatives, distribution systems that organize G&T's to transmit Government power from the dams to them, and they, in turn, organize Basin Electric, which is a wholesale power cooperative that builds generating plants. When you take the interest costs paid by Basin Electric on its guaranteed loans from REA and add to it the interest cost of East River, that I work for, the distribution system's wholesale power bill for East River contains 34 percent interest cost, and that is a monumental burden when you consider the past experience of utilities in the United States, to consider having to pay 34 percent of your bill, of the wholesale power bill, in interest costs.

I bring that to the attention of the committee because to ignore the needs of distribution systems would simply add to that burden, which I believe is already very substantial.

One of the ways to ease that burden would be to retain in H.R. 3050 the provisions for refinancing the guaranteed loans, and I strongly urge that you do that, inasmuch as it would have perhaps the most stabilizing effect on future cost of electricity in rural areas.

Having said that, I do urge very strongly that the capitalizing of the Revolving Fund be retained as essential for the survival of the Revolving Fund for the long period and maintaining this relationship with Congress that I spoke about.

Finally, I would like to appeal to this committee from those areas confronting conditions much like the earliest and most difficult days of rural electrification, areas of low population density, areas economically depressed, and those frequently hit by storms and suffering damage of a monumental kind, where sometimes three-quarters of an electric system is knocked to the ground.

I would urge that the committee consider making the special interest rate a mandatory provision of the bill, making it mandatory upon criteria set by the Congress that recognizes that there are some systems yet today—and I am talking about those systems in the Dakotas and Nebraska, Montana, Texas, New Mexico, systems serving less than two, sometimes less than one, consumer per mile—that Congress continue to recognize, as it has in the past, that they do have special needs and, therefore, that the Adminis-

trator ought to be required, at least under some reasonable criteria set by Congress, to provide special interest loans.

Mr. Chairman, I appreciate very much the opportunity to appear before this committee, and I will be prepared to answer any questions you may have.

[The prepared statement of Mr. Feragen appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Feragen. We do appreciate the time that you have taken to be here with us and the interest that you have shown, as well as the good job that you did when you were the REA Administrator.

Now for Mr. Dave Hamil's statement, who was necessarily detained and not able to be here today, we will hear from John Davenport of NRECA, who will read Mr. Hamil's statement. Mr. Hamil is also a former REA Administrator whom all of us recall and remember.

John.

**STATEMENT OF DAVID A. HAMIL, FORMER ADMINISTRATOR,
RURAL ELECTRIFICATION ADMINISTRATION, PRESENTED BY
JOHN DAVENPORT, NRECA**

Mr. DAVENPORT. Yes, sir, Mr. Chairman.

For the record, my name is John Davenport, a member of the staff of NRECA, and I will present the statement of Mr. David A. Hamil, former Administrator, Rural Electrification Administration.

For the record, my name is David A. Hamil. I am a resident of Sterling, Colo., and have been involved in the rural electrification program for more than 40 years. It has been my privilege to serve as Administrator of the Rural Electrification Administration for more years than any other person, having held the position from 1956 to 1961, and again from 1969 to 1978.

Let me say, also, that I'm delighted to have the chance to once again appear before this subcommittee. As you and your colleagues know, Mr. Chairman, during my times as REA Administrator it was my duty—and most of the time, at least, my pleasure—to frequently report to this subcommittee on the progress and problems of REA and the rural electrification program.

It was just about 10 years ago, Mr. Chairman, that Congress put into effect major changes in the REA lending program.

Up to that time, all Government loans for rural electrification had been made under the old direct program, with the vast majority of them made at a 2-percent interest rate.

While the amount Congress was making available each year for REA direct loans was growing, it was not growing anywhere near as fast as the co-ops' need for financing. Direct loans in the early 1970's had reached nearly a half billion dollars per year. But even then, we knew we were on the verge of a new era in the rural electrification program, one which would have a tremendous impact on the need for new capital.

First of all, many co-ops were experiencing rapid growth in numbers of new consumers as the long tradition of rural-to-urban migration reversed itself and increasing numbers of Americans moved from the cities to the country.

In addition, the cost of extending lines and building new facilities was rising very fast. This was due to the effects of inflation and to the often complex and expensive new requirements placed on REA borrowers as a result of the great wave of environmental legislation that came into being in the early seventies.

By far the most critical challenge faced by the co-ops at that time, however, was the growing realization that rural electricians would have to move—and move quickly—into the power supply area.

Up to that point, co-ops acquired most of their power by wholesale purchases from investor-owned companies or federally owned power projects. As we entered the seventies, though, co-ops were getting a very clear message that the power companies did not want to expand solely to meet the power needs of their wholesale customers. Co-ops also were beginning to see the bottom of the barrel with regard to Federal power, at least insofar as meeting future demand growth was concerned.

This left the co-ops with no choice but to move toward increasing self-reliance for power supply, by building generating and transmission facilities owned and operated by the co-ops, or through facilities jointly owned with power companies or other utilities.

The problem, of course, was in the fact that the capital needed for just one medium-sized generating plant would have taken up REA's entire loan authorization for the year. Clearly, the old direct loan program was not designed for, nor could it handle, this next phase in the development of rural electrification.

This is why the REA lending programs created by Congress through Public Law 93-32 have been so very important to the continued progress and success of the rural electric program.

Even though they were put together under some very difficult circumstances in the months following the abrupt cutoff of REA lending in December 1972, today's insured and guaranteed loan programs have made it possible for REA to continue its longstanding and still vital role as the primary capital source for rural electrification.

All of us are aware, I'm sure, of the many things that have happened in the past 10 years that have had an effect on rural electricians and their financing needs.

The 1973 oil embargo and resulting national commitment to the goal of energy independence speeded up even further the pace of powerplant construction to replace oil- and gas-fired units.

Interest rates have hit levels no one could have predicted 10 years ago, and inflation, at least until this past year or so, has continued at a very high rate.

Ever-tightening environmental standards on powerplant emissions have not only increased the cost of constructing new facilities, but also increase ongoing costs, since the energy required to run pollution control equipment can take as much as 8 percent of the output of a powerplant.

All these things have had their effect on REA lending, and in particular on the financial health of the Rural Electrification and Telephone Revolving Fund, which Congress created in 1973 to serve as the capital source for REA-insured loans.

And, all of these factors will continue to play a role in the future of the REA financing program, as the growth and revitalization of rural America continue in the years to come, and rural electric systems continue to meet their responsibility of providing all the electric energy their consumers need at a reasonable cost.

Mr. Chairman, as you may know, I took part as an *ex officio* member in the study recently completed by NRECA's Committee on Financing for the Future. I can tell you from firsthand experience that this committee left no stone unturned in its search for a way to insure that rural electricians will have access to the amount of capital they must have in the future, and at a cost rural electric consumers can afford to pay.

I personally am satisfied that the recommendations which this study committee developed, and which are contained in large measure in H.R. 3050, are both reasonable and fair to the REA borrowers and to the Nation as a whole.

If implemented in a positive and forthright manner by the person sitting in my old chair at REA, I believe they can bring about the kind of self-perpetuating financing system that Congress had in mind when the Revolving Fund was created 10 years ago. The proposed changes in the REA Act also will help iron out a few kinks in the lending process, and, in the long run, help make the borrowers financially more able to look to lenders other than REA for their future capital needs.

It's worth noting, I think, that the rural electricians have made great progress during these past 10 years in increasing their use of non-REA, private capital sources. At present, only a small fraction of the new capital investment in rural electrification is in the form of REA loans at interest rates of 5 percent or less. For most of the past decade, the majority of the new loan funds have been either in the form of REA guarantees—which are at the full cost of money to the Government—or as supplemental loans made by CFC and other private lenders at open-market rates.

The legislation before the subcommittee today would not by any means stop this process of "weaning" the rural electric borrowers from what not that long ago was a total dependence on REA. To the contrary, it gradually and on a reasonable basis narrows the gap between the REA standard rate and market interest costs. It also leaves the door open for future adjustments in the supplemental loan requirements, allowing the Administrator to move the financially strongest systems toward financial independence even faster.

Mr. Chairman, with your indulgence, I'd just like to say a word or two on the question of the "subsidy" rural electric and telephone systems derive from their access to REA financing, and the controversy that has arisen on the provision in H.R. 3050 to convert some \$7.9 billion of notes REA owes to the Treasury into permanent capital for the Revolving Fund.

First, on the question of subsidy, let me say that while a lot of people have been arguing about a lot of specific numbers, I think all of us have come to agree that there is not a single consumer of electric power in this Nation whose monthly bill is not, to some degree, subsidized by the Federal Government. Personally, I think that's fine. Electric power has become such a basic necessity of life

that there's nothing wrong with Government taking steps to insure that all Americans can get what they need at a reasonable price.

Whether or not the amount of subsidy being received by each type of utilities—investor-owned, municipal, and rural electric—is exactly equal is, in my opinion, not really that important.

Reasonable comparability of rates should be the determining factor, and if the rural electrics need a little extra help to achieve that goal, I think it's a worthwhile investment of our Government's resources to give them that help. This is particularly so in light of the tremendous benefits the Nation as a whole receives from the improvements rural electrification has made possible in agriculture—preserving our abundance here at home, while helping maintain our trade balance abroad.

This point relates directly, of course, to the issue of the \$7.9 billion conversion provision of the bill which some of those who oppose it have termed "forgiveness," or a "bailout."

Here again, I've never been inclined to argue bookkeeping with the bookkeepers. But when you boil everything down, there are two facts that remain unchallenged.

First, that no existing or future REA borrower will be released of its responsibility to repay every penny of the money lent to it, including all of the interest agreed to in the terms of the note.

And, second, that all of the funds used for rural electrification, whether they are in the Revolving Fund, the Treasury, or anywhere else, will always be owned and controlled by the people of the United States, through their elected representatives in Congress.

Should the time come that the need for REA financing ceases to exist and the Revolving Fund is liquidated, all of these funds would revert to the Treasury. It's simply a matter of the Fund being allowed to continue its use of these funds for as long as they are needed, instead of having to give them back at the end of an arbitrary 40-year period.

Some have attacked this aspect of the proposal on the ground that it may have the effect of reducing Treasury revenues in 1993 and beyond. But even if there are some costs involved, rural electrification always has been—and will continue to be, in my opinion—among the best investments Government has ever made.

Mr. Chairman, again let me say how good it is to be back again before this distinguished panel, and how much I appreciate this chance to express my support for H.R. 3050.

Thank you.

Mr. JONES of Tennessee. Thank you very much, John, for delivering Mr. Hamil's very fine statement. We appreciate it more than you know.

Before I present the next witness, I want to recognize a particular person who is in the audience this morning. We are delighted that he is here. He is a former member of the Agriculture Committee, which makes him a former Member of Congress. He is a former chairman of this particular subcommittee, a former Secretary of Agriculture, and, more recently, has been selected by the NRECA to become its executive vice president, upon the retirement of Bob Partridge, our good friend Bob Bergland.

Bob, would you stand up and just be recognized?

Mr. BERGLAND. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. We are delighted that you are here.

Mr. BERGLAND. Thank you, sir.

Mr. JONES of Tennessee. We are looking forward to seeing more of you. We miss you.

We asked Mr. Albosta earlier, who is a Member of Congress, to be here for a statement. When he came, we had already begun with a panel. He was kind enough to come back, and he is here now.

Don Albosta, a Member of Congress from the great State of Michigan, we will recognize you now for a statement.

We are delighted that you are here, Don.

**STATEMENT OF HON. DONALD J. ALBOSTA, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF MICHIGAN**

Mr. ALBOSTA I certainly apologize, Mr. Chairman, and to the members of the committee, for not being here when this committee convened this morning, as I was supposed to be. For that, I apologize.

Mr. JONES of Tennessee. No apology is necessary. We understand.

Mr. ALBOSTA. I appreciate the opportunity to be before you, Mr. Chairman and members of the Subcommittee on Conservation, Credit, and Rural Development.

I thank you for this opportunity to testify before you concerning H.R. 3050, the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983.

I do not believe that I need to dwell on the sensible proposals included in H.R. 3050; I am sure that you are already well-versed on the specifics. Instead, I would like to emphasize the important role that rural electric cooperatives play in rural America, which ably demonstrates the need for this bill to insure the solvency of the Revolving Fund and the viability of the rural electric cooperatives.

In Michigan there are 13 distribution cooperatives and 1 generation and transmission co-op that serve over 500,000 citizens in rural areas covering all or part of 58 counties—about half the State's land area. By providing this power where it otherwise might not be available, the co-ops have made possible the growth of new business and industry and has allowed American farmers to produce more effectively and efficiently than any place else in the world.

As a farmer myself, I am particularly impressed with the growth of agriculture to where it now ranks second only to automobile manufacturing in top industries in Michigan. As a rural American, I fully appreciate the contribution of co-ops toward jobs, development, and the enhancement of rural life.

Rural electric co-ops face unique problems that require special assistance. Because of the large distances with few customers that are covered, these areas are expensive to service and result in small revenues. Additionally, there are many low-use seasonal customers of co-ops, particularly in my district where summer cottages and hunting cabins abound for vacationers from urban areas. This demonstrates the common interest that urban dwellers share in

the solvency of the Fund, since they, too, are often at least part-time customers of the rural cooperatives.

The fact that the average investment per customer is much higher for rural co-ops than for investor-owned utilities is demonstrated in Michigan, where the investment is \$1,340 per co-op customer, compared to \$825 for investor-owned utilities. Additionally, the interest costs are significant for the rural co-ops since portions of their loans are made at current interest rates. For quite a while now, interest costs have exceeded income.

Rural electric cooperatives continue to take steps to meet these special challenges. They use their money efficiently, keeping costs and personnel at a minimum—Michigan co-ops are among the most efficient in the Nation. Additionally, they have an outstanding repayment record on their loans.

With this bill, the rural electric co-ops are not asking that their loans be forgiven; they are asking for assistance in meeting their goal of maintaining the solvency of the Fund upon which rural communities depend. They are to be commended for taking the initiative now to strengthen the Fund.

In closing, I urge your favorable consideration of this bill, which is so vital to rural communities.

I would be glad to answer any questions that any of the members might have.

Mr. JONES of Tennessee. Thank you very much, Don, for a very fine statement. We do appreciate it. We are not detaining Members of Congress by asking questions. If we have questions to ask, we are going to do it by correspondence.

Mr. ALBOSTA. Fine.

Mr. JONES of Tennessee. We do appreciate the time and the interest and the effort that you have made to be here.

Mr. ALBOSTA. Again, I thank the chairman and the members for my opportunity to be here with you this morning.

Mr. JONES of Tennessee. At this point I would like to ask unanimous consent to a request of a member of the committee, Mr. Durbin, to file a statement for him, one that he wanted to give but he had to go to another subcommittee. If there is no objection, I will ask that his statement become a part of the record, also.

[The prepared statement of Mr. Durbin appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Now the next panel consists of Mr. Charles Gill, the governor of the National Rural Utilities Cooperative Finance Corp., here in Washington; Mr. Robert Edmiston, the executive vice president, Lehman Brothers Kuhn Loeb, New York; Mr. Donald E. Smith, chief economist, NRECA; and Mr. Gene L. Swackhamer, president of the Farm Credit Banks of Baltimore.

Gentlemen, we are delighted that all of you are here.

I don't know who's going to take off first. I'm going to leave that to you. You may just do it in any fashion that you please. Make yourselves at home and announce which one decides to lead off.

Mr. Gill, it may be you, I don't know, because your name appears first.

STATEMENT OF CHARLES B. GILL, GOVERNOR, NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP.

Mr. GILL. Thank you, Mr. Chairman and members of the committee. I appreciate the opportunity to appear before your committee.

My name is Charles B. Gill. I am chief executive officer of the National Rural Utilities Cooperative Finance Corp., commonly referred to as CFC.

I have submitted a statement to the committee, and I request that it be filed for the record. With your permission, Mr. Chairman, I will make a very brief statement, summary statement, on the testimony.

Mr. JONES of Tennessee. Without objection, the entire statement will become a part of the record, and you may summarize as you please.

Mr. GILL. Thank you.

As Mr. Vann indicated this morning, CFC was formed in 1969 by the rural electric systems in order to assure a source of capital to meet the funding needs not provided by REA.

CFC currently has 928 members. These members have invested various forms of equity capital in CFC amounting to over \$700 million. CFC currently has loans outstanding, loan commitments, and guarantees of member debt in excess of \$7 billion. Of this amount, over \$3.6 billion is loans and guarantees outstanding, under which we share a mortgage position with REA.

The matter of current REA policy regarding the sharing of its mortgage through lien accommodation is of significant interest to CFC and its members. This matter is addressed through proposed amendments to the REA Act in H.R. 3050.

In section 306 of the 1973 REA Act amendments Congress authorized the Administrator to accommodate the lien on mortgages held by REA. In the House committee report on the bill emphasis was placed upon the authority the Administrator to accommodate and subordinate the mortgages held by REA for the purpose of facilitating non-REA lending in the program. Since that time, REA has taken what we believe to be a restrictive interpretation of the Administrator's authority under the act.

Three considerations appear to determine the Administrator's favorable consideration of a lien accommodation request. These are: First, that there is compensating benefit to the Government; second, that there is dollar-for-dollar physical security in place to match the financing; and, third, that the accommodation be granted only if REA could make a loan for the purpose of the financing.

CFC believes that these interpretations are not in the best interest of the rural electric systems or their members, and run counter to the intent of Congress regarding the infusion of private capital into the program.

Several specific examples of financing efforts which would have provided lower cost to the rural electric systems that could have been put in place but were not, due to the absence of lien accommodations, could be cited. Suffice it to say we believe reduced costs resulting in more viable systems, with a greater ability to repay their debt to the Government, is in the Government's interest and should, indeed, be considered a compensating benefit to the Gov-

ernment, and should allow for a more aggressive attitude on the part of REA in granting lien accommodations.

As to the second policy position of REA, that of requiring physical security to match the amount of financing, mortgages on physical plant are not a matter of interest in municipal or public utility financing. Rather, revenue flow is the primary measure of lender security.

We believe a similar consideration in regard to rural electric systems on the part of REA is necessary if we are to maximize the efficiency of these systems.

As to the last point, if REA must be able to make a loan in order to grant a lien accommodation, we believe this is a contradiction to the stated position of infusing non-Federal capital into the rural electric program.

One might ask why CFC would desire a mortgage on the physical assets of a system if we believe the ability to repay the loan is the criteria to be used by the Administrator in granting lien accommodations. The reason for the CFC position is that the REA mortgage as currently written provides for a lien not only on the physical facilities, but also on all revenues generated, as well as future acquired properties and revenues. Since the assurance of repayment is tied to revenue flow, it is important that a mortgage position be held.

H.R. 3050 provides for a feasibility finding as the only consideration of the Administrator in granting a lien accommodation for a proposed financing.

Mr. Chairman and members of the committee, we believe the objectives of the REA Act and the interest of the rural consumers will best be served with the enactment of the amendments presented in section 7 of H.R. 3050.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Gill appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Gill, for a good statement. We appreciate your time, your effort, and your interest in being here.

Our next witness is Mr. Robert Edmiston.

STATEMENT OF ROBERT R. EDMISTON, PRINCIPAL, LEHMAN BROTHERS KUHN LOEB, INC., INVESTMENT BANKERS, NEW YORK

Mr. EDMISTON. Good morning, Mr. Chairman.

My name is Robert Edmiston. I am a principal of Lehman Brothers Kuhn Loeb, New York. We are an investment banking firm.

I would like to submit a prepared statement, Mr. Chairman, for the record, with one minor correction, and then give you some excerpts and summary comments from that particular statement, with your permission.

Mr. JONES of Tennessee. Without objection, your entire statement will become a part of the record, and you may summarize as you please.

Mr. EDMISTON. Thank you, sir.

I just wish to make one correction at the outset. On the next to the last paragraph of page 8, in the next to the last line, I would like to add the word "REA" after the word "continuing," so that the statement would read, "Meaningful access to the private capital markets will have to be developed over a period of years and in the context of a strong continuing REA commitment during a monitored transition."

Thank you.

Mr. Chairman and members of the subcommittee, I appreciate this opportunity to discuss various aspects of private market financing for rural electric cooperatives. My firm, Lehman Brothers Kuhn Loeb, Inc., has been closely identified with the financing of rural electric cooperatives for almost two decades. It has served as principal investment banker for National Rural Utilities Cooperative Finance Corp., CFC, since its founding 14 years ago. My primary responsibility for the past 7 years has been the providing of various investment banking services to rural electric cooperatives, principally through CFC.

I would like to comment on four aspects of rural electric cooperative financing. Initially, I will talk about the development of private market financing for rural electric cooperatives. Then I will talk about the market acceptance of CFC's obligation. Then I will talk about the financial condition of rural electric cooperatives, and I will finally discuss the importance of REA financing to assure adequate power for rural electric cooperatives.

Initially, let's talk about the development of private market financing for rural electric cooperatives. The rural electrification program is about to enter its sixth decade, having undertaken to render a continuing public service essential to the health, safety, and livelihood of their rural member consumers. Government support has been used intelligently and with integrity to build a sound industry of over 1,000 electric utility systems. These utility systems have not been satisfied to rely solely on Government financing. Beginning 15 years ago, they instituted a self-help effort which resulted in the formation of CFC.

CFC, created in 1969, was an untried and untested financial institution that had one overriding objective—to provide its members with reliable and cost-effective access to private capital markets. Fundamental to the achievement of this objective was the realization that the rural electric systems could obtain capital at a lower cost by working together than they could be marketing their credits individually.

Prior to the formation of CFC, non-REA financing was relatively modest. We had private market financing by Buckeye Power in Ohio for a powerplant project prior to the formation of CFC. CFC has, since the inception of its loan program in 1973, provided over \$1.8 billion of long-term loans to REA borrowers, and it has constituted by far the major source of private funds to supplement REA-insured loans to distribution cooperatives.

The major source of financing for power supply cooperatives has been through the funding of REA guarantees by the Federal Financing Bank. Significant sources of supplemental funds for power supply cooperatives have been the tax-exempt pollution control rev-

enue bond market, lease transactions, the banks for cooperatives, and commercial banks.

CFC has provided a total of \$3.6 billion in intermediate loans, principally to finance frontend expenditures for powerplant construction, and also \$1.2 billion of its tax-exempt pollution control revenue bond financing guarantees to power supply borrowers.

Rural electric cooperatives have steadily enlarged their participation in the private capital markets in recent years. Their securities are gaining increased market acceptance. However, the percentage of long-term debt obtained outside the REA has not changed much in recent years, as the REA annually continues to supply about 90 percent of long-term debt requirements for the rural electric cooperatives. While the percentage has changed very little, there has been a tremendous expansion of investment in power supply facilities by the cooperatives in all regions of the country to keep up with demand.

From 1973, when the REA Act was amended to authorize loan guarantees, through 1982, REA had guaranteed about \$30 billion for power supply financing requirements. Thus, while the increase in private market financing for cooperatives has been significant, its share of total long-term financing has been fairly constant in recent years because of the rapid growth of capital required.

The following comments relate to market acceptance of CFC:

We have witnessed a steady improvement in the quality of CFC, its credit rating, and investor acceptance of its obligations. Its initial entry into the capital markets was in 1973, when it raised supplemental funds for distribution cooperatives by offering \$50 million of its collateral trust funds.

At the outset, because it was a new and unique concept, untried in the market, its collateral trust funds were given an "A" rating. Although this is an investment grade rating and the level of most of the investor-owned utilities at that time, CFC aspired to better. In 1975, one agency upgraded CFC to "AA," and in 1979, it became "AA" by both of the major credit ratings. I should point out to you that the four major investment grade credit ratings that investors rely on are "AAA," "AA," "A," and "BBB."

CFC's credit rests on the quality of its member borrowers and the risks associated with any financial intermediary. The recent decline in distribution cooperatives and CFC's interest coverage ratio has produced some pressure on the relative valuation of its debt by the market. Although these trends appear to have been arrested, a resumption of these trends would impair CFC's ability to provide capital to its member at favorable rates.

CFC has also been active in two other markets: The tax-exempt market and the taxable commercial paper market. CFC guaranteed tax-exempt obligations to finance pollution control revenue bonds for rural electric cooperatives are presently rated "A1" by Moody's Investors Service and "AA-" by Standard & Poor's Corp., having recently been upgraded from "A2" and "A+," respectively.

The credit ratings and market acceptance attained by CFC signify many things. It shows that CFC was soundly conceived by its founders and that its organization and purpose has stood the test of time. It has demonstrated that it is being prudently and responsibly operated and managed. Finally, it shows confidence in the sus-

tained quality of CFC's member borrowers and the excellence credit record of rural electric cooperatives since their inception.

In the final analysis, the fundamental credit and acceptance by the marketplace depends upon the quality of its loan portfolio.

Next I will comment on the financial condition of rural electric cooperative systems. In the past 10 years the operating environment for the entire electric utility industry has undergone dramatic change. Prior to this period, the industry was relatively stable, with the growth and demand for electricity highly predictable. All of that changed with inflation and enormous increase in fuel costs that took place in the 1970's. This, in turn, increased capital costs for new generating plants. We discovered the surprising price elasticity of electrical energy demand and cut back on consumption. Consumers pressured management and regulators to minimize rate increases and, consequently, the financial position of all utilities eroded.

The events of recent years create a more than normal uncertainty to the outlook. Not only have the business risks increased, but so, too, have the financial risks. Utilities have less to offer investors in an increasingly competitive, volatile, and changing capital market.

Recent efforts to improve the financial position of rural electric distribution cooperatives have met with some success. However, current interest and debt service coverage ratios of the distribution cooperatives are barely adequate to assure the availability of supplemental capital at reasonable cost.

Two significant measures of financial strength, the interest coverage ratios and the ratio of equity to assets, have an important impact on the ability of cooperatives to attract capital and the cost of that capital. Both of these ratios have deteriorated in recent years.

Other important factors bearing on the cost and availability of private market capital for rural electric cooperatives are:

One, the magnitude of REA capital availability and the supervisory role deriving from conditions of the REA mortgage;

Two, prospective capital requirements and constructions programs;

Three, regulatory and legislative environments;

Four, underlying economic base of the service areas; and

Finally, the strength of the power supply contract between the power supply cooperative and its distribution members.

The credit quality of the entire utility industry has declined in recent years and, on balance, the rural electric component, due to its special characteristics, is judged from a credit perspective to be weaker than the credit of the investor-owned utility industry. As supplemental financing increases, the financial standards of rural electric cooperatives may require modest improvement to assure access to capital on reasonable terms.

Finally, I would like to very briefly discuss the importance of REA financing to assure adequate power for rural electric cooperatives.

Basic to the assurance of a reliable supply of power is the availability of capital to finance needed plant additions. The securities market in recent years has become highly volatile with competition

for funds, especially long-term funds, intensifying. Rapid and unexpected changes in interest rates, and changes in investor objectives, have been revolutionizing our securities markets.

For power supply borrowers, access to the REA guarantees with funding through the Federal Financing Bank has provided favorable borrowing costs. However, the greatest benefit which REA has consistently provided to rural electric systems is guaranteed availability of long term capital.

Given the nature and magnitude of power supply requirements, \$30 billion of guarantees since 1973, we believe that without the REA guarantee program this volume of funds could not have been raised from the private market in the amounts and maturities required.

Our firm recently completed a study, "Report to the Committee on Objectives and Planning of National Rural Utilities Cooperative Finance Corporation," which analyzed the expected capital needs of rural electric cooperatives and their ability to meet these requirements in the private capital market under various levels of Government support. A summary of the conclusions of this report is appended.

The report examined the expected capital needs of power supply cooperatives over the next few years against assumed future levels of REA support. We concluded that if REA guarantee availability is not sufficient, that the private market could accommodate a portion, but not all, of the anticipated capital needs. Meaningful access to the private capital markets will have to be developed over a period of years and in the context of a strong, continuing REA commitment during a monitored transition.

It is important to note that if the development of supplemental financing for power supply cooperatives proceeds in an orderly manner, private market capital can be attracted without a substantial and costly enhancement of rural electric financial standards. As noted in the appendix, the means exist for power supply systems to use a collective financing vehicle, similar to CFC, to achieve the greatest efficiency of access to the capital markets at the lowest cost through the pooling of individual power supply credits.

As rural electric cooperatives continue their efforts to enlarge their participation in the private markets, it is essential to offer investors adequate security for their loans. The Government must be willing to equitably share its all-encompassing security interest with private lenders. The proposed amendment to section 306 of the Rural Electrification Act, particularly with respect to the accommodation of liens of non-REA lenders, will facilitate and further the development of non-REA credit for rural electric cooperatives.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Edmiston appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Edmiston. We appreciate very much the fact that you are here.

Our next witness is Mr. Donald E. Smith, chief economist for the NRECA.

Mr. Smith.

**STATEMENT OF DONALD E. SMITH, CHIEF ECONOMIST,
NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION**

Mr. SMITH. Thank you, Mr. Chairman.

My name is Donald E. Smith. I am chief economist with NRECA.

I would like to request that my statement be submitted for the record in full, and I will summarize very briefly in the interest of time.

Mr. JONES of Tennessee. Without objection, the entire statement will become a part of the record, and you may summarize.

Mr. SMITH. Thank you, sir.

From the comments made by the committee members yesterday, I think that they are all aware of the levels and types of Federal assistance provided to each of the electric utility sectors. The municipal publicly owned electric utilities are eligible to raise capital for all of their financing needs from tax-exempt financing, the interest on which is not taxed for Federal income tax purposes. This results in a revenue loss to the U.S. Treasury estimated at \$331 million per year, or about \$40 per consumer of the publicly owned systems.

The investor-owned utilities have tax benefits through the accelerated depreciation and the investment tax credits, totaling about \$3.6 billion a year. This is a substantial amount of Federal assistance that is provided, we think appropriately, to the investor-owned utilities.

I would like to mention that Administrator Hunter yesterday referred to a study conducted by Dr. Donald Keifer, a utility tax specialist with the Congressional Research Service. Dr. Keifer's entire study, which I have here, indicated that his results clearly imply that a taxable utility may be receiving larger subsidies through the investment credit and accelerated depreciation than are available through tax exemption and loan subsidies to a rural electric cooperative. He did conclude, however, that overall who receives the larger subsidy depends on the discount rate used in the present value analysis.

Dr. Keifer's study is not conclusive, but he is fully aware of the very large and increasing amounts of Federal assistance that are provided to the investor-owned utilities.

I would like to submit as an exhibit the results of an analysis that we requested of Dr. Lawrence Klein of the University of Pennsylvania, a Nobel Laureate economist, who reviewed our material without compensation and concluded that our report is sensible, well-balanced, and well-reasoned. I would like to include this as an exhibit, if I may, in its entirety.

Mr. JONES of Tennessee. Without objection.

[The material follows:]

UNIVERSITY of PENNSYLVANIA

PHILADELPHIA 19104

LAWRENCE R. KLEIN
Benjamin Franklin Professor of Economics

DEPARTMENT OF ECONOMICS
 3718 LOCUST WALK CR

TO: Donald E. Smith
 FROM: Lawrence R. Klein *Lawrence R. Klein*
 DATE: April 8, 1982
 SUBJECT: Review of materials on federal assistance to electric utilities

Thank you for sending me the materials on "Comparing Capital Costs..." I have read this document and have a few specific comments to offer about a few issues but, overall, I think that you have made a correct and revealing analysis.

It is well known, all over the world, that central governments subsidize or support home industries. One of the most common forms of subsidy in this connection, is through the granting of financial concessions on business borrowing.

As you argue in your document, publicly owned electric utilities, rural electric cooperatives, and investor owned electric utilities all enjoy some form of subsidy. The table presented on Industry Comparative Data tells an interesting and plausible story. I cannot say whether the precisenumbers used are wholly correct, especially on effective capital cost. While I do not have the information readily available to check your quantitative magnitudes, I can assure you that each of the arguments is qualitatively correct. They point in the right direction.

The magnitudes that you have presented appear to me to be direct, first-round effect. The lower interest rates charged effectively to electric utilities have secondary effects.

They might contribute to "crowding out" of other borrowers when times are brisk. They have the effect of raising costs to other borrowers and also enlarging the public deficit. These changes affect capital formation at large and are felt throughout the economy, affecting recovery, and growth.

The standard REA rate that you cite on page three (at 5%) must surely be subsidized too. The Carter Administration proposed, as you note on page five the making of investment tax credits refundable. To some extent the same concessions may be realized through the Reagan Administration's policy of allowing transfer of credits from unprofitable companies, who cannot use them, to profitable companies. This affects all industry and is not specific to electric utility financing. The sale of credits is not working out exactly as it is thought that refunding would work. The revenue loss from present provisions concerning transfer of unused credits away from companies who are not making profits, or at best only small profits, is proving to be very large and Congress may restrict their use in this particular mode.

The report is sensible, well balanced, well reasoned. Without having checked the individual numbers presented, I can say that I believe that you are making sound arguments.

Mr. SMITH. One additional tax benefit provided to investor-owned utilities in 1981 by ERTA was dividend reinvestment, whereby stockholders may take up to \$1,500 per couple in new stock annually in lieu of cash dividends, and thereby pay no taxes. This benefit is providing the IOU's with common stock capital at an annual rate of \$2.6 billion, representing about 50 percent of their stock requirements. The cost to the Treasury of this new benefit provided to gas and electric utilities exclusively, has been estimated by the U.S. Treasury to be \$416 million during the current fiscal year. This tax expenditure of the dividend reinvestment benefit is in addition to that of the investment tax credit and accelerated depreciation, so that the total Federal assistance to investor-owned utilities exceeds \$4 billion annually.

Again, according to Dr. Keifer, the investor-owned utilities will be having a greatly increasing annual benefit, according to his numbers, increasing this year by \$925 million, to the point that the investor-owned utilities will be retaining the entire amount collected from their ratepayers for the purposes of Federal taxation.

It is important to point out to members of the committee that this administration has proposed and supported legislation greatly expanding the tax assistance provided to the investor-owned utilities. They have done so in response to the serious difficulties which have beset the utilities in recent years.

We have great difficulty, however, in understanding the increased assistance to IOU's, on the one hand, and the administration's persistent efforts to reduce drastically the minimal assistance provided to the rural electric systems, on the other. Its recognition of the financial dilemma of the IOU's serving the densely settled urban areas and total disregard of the greater need of the utilities serving the most sparsely settled, three-fourths of the Nation's land areas is particularly baffling.

In conclusion, we believe that it is of critical importance for the Congress and public to realize that the three electric utility sectors each receive and require Federal assistance. This administration recommended, and the Congress approved, legislation greatly expanding the Federal assistance to the investor-owned utilities. The Federal assistance to the IOU's and publicly owned utilities far exceeds that to the cooperatively owned utilities, as is indicated in table 1 of my statement, despite the co-ops' relatively adverse operating and financial characteristics, which I have listed on table 2 of the statement, which we think is very important for comparative purposes.

Passage of the proposed legislation will help redress this inequity in Federal assistance by preserving a viable REA financing program to insure the availability of reliable and affordable electric service throughout rural America.

Thank you very much.

[The prepared statement of Mr. Smith appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Smith, for a very fine summary, and we do appreciate your time and interest in being here.

Our final witness today is Mr. Gene Swackhamer, president of the Farm Credit Banks of Baltimore.

It is good to see you again, Mr. Swackhamer. We appreciate your being here and the interest that you have in NRECA.

STATEMENT OF GENE L. SWACKHAMER, PRESIDENT, FARM CREDIT BANKS OF BALTIMORE

Mr. SWACKHAMER. Fine. Thank you, Mr. Chairman.

I am Gene Swackhamer, president of the Farm Credit Banks of Baltimore.

With your permission, I would like to submit the entirety of my prepared text for the official record and then summarize by paraphrasing from some sections of it.

Mr. JONES of Tennessee. Without objection, the entire statement will become a part of the record. You may summarize as you please.

Mr. SWACKHAMER. Thank you.

The Farm Credit Banks of Baltimore are collectively the Land Bank, the Bank for Cooperatives, and the Intermediate Credit Bank.

I am here today on behalf of the 13 Banks for Cooperatives to offer testimony in support of H.R. 3050. I am particularly interested in bringing to your attention the involvement and commitment of the Banks for Cooperatives in rural electric lending.

The rural electric program and the Banks for Cooperatives were both organized at about the same time. The BC system first became involved in rural electric lending in a very minor way in the 1940's, but it was not until after passage of the 1971 Farm Credit Act that the BC system became to gain experience and develop significant lending relationships with rural utility cooperatives. This occurred primarily because the REA began to require rural electric cooperatives to find part of their financing elsewhere, and also because of the commitment of the Banks for Cooperatives to rural organizations.

Additionally, with lower farmer ownership eligibility requirements, many Banks for Cooperatives saw rural electric cooperative lending as a way to diversify their loan portfolios for risk management purposes.

Today the rural utilities market is well served by two supplemental lenders: the National Rural Utilities Cooperative Finance Corp. and the Banks for Cooperatives. From the beginning, the BC's have tried to develop both large borrower G&T market as well as the smaller distribution cooperative market.

I think the BC's have much to offer to rural utilities—a large funding capacity, generally favorable interest rates, and a service-oriented cooperative philosophy. Many BC's have also made long-term organizational commitments to serve rural utilities.

In the more than 10 years that have transpired since passage of the 1971 act, rural utility cooperatives have become an integral part of the BC's agribusiness cooperative membership. Today 9 of the 12 district Banks for Cooperatives have loans and/or commitments to nearly 200 rural utility cooperatives, totaling in excess of \$2 billion. While this represents only a small portion of the farm credit system's loan volume, and only a small number of its cooperative borrowers, I believe it is evident that our banks have made a

commitment to rural utility lending and are making every effort to provide funds and services that will meet the future needs of borrowers.

While the Banks for Cooperatives work with telephone, distribution, G&T, the lion's share of our rural utility loans is made to generating and transmission organizations. We recognize that power usage has declined substantially in recent years, and probably will not increase appreciably in the foreseeable future. However, our commitment is for the long term, and we do expect the business to remain sound well into future decades.

G&T's are very capital-intensive projects. Our involvement in this area has been primarily as the role of a supplemental lender. For instance, we do financing, bridge financing, and some projects in participation with other sources of credit.

However, there are several factors which limit the role of the BC's in financing rural utilities, one of which will be addressed significantly in your successful passage of H.R. 3050.

I would like to comment on three of these—eligibility, lending limits, and credit worthiness. The BC's are required by law to provide loan funds only to eligible cooperatives. Current law provides that for a cooperative to be eligible for a BC loan the number of farmer members must be at least 60 percent or higher, if so decided by any bank board of directors. We believe this requirement effectively eliminates a substantial number of rural utilities from BC borrowing.

A second factor affecting the extent to which the BC's can become involved in rural utility lending is our own lending limits. The lending limit for any term loan for a single credit risk is 25 percent of our system net worth or 50 percent if the loan carries a full-faith Government guarantee. Considering that the present net worth of the BC system is approximately \$1.2 billion, our maximum line of credit to a single guaranteed borrower would be \$600 million. While this is large in itself as a single credit risk, it is not sufficient to carry the entire needs of most of the G&T cooperatives.

A third factor affecting the BC's ability to lend to rural utilities is the question of credit worthiness of borrowers. Many of our G&T systems are fairly young systems and have fairly low equities, about 1 to 5 percent of equity against total assets. From our perspective, these low ratios indicate a continuing need for Government guarantees which most of our term loans carry.

The point I am making, Mr. Chairman, is that we want you to know, and we want REA and the rural utilities to know, that within the limits just outlined, the Banks for Cooperatives are a very willing participant in the financing of rural utilities. We will continue to work with rural utility systems to this end.

I would like now to just comment briefly on some specific need for H.R. 3050. When the REA program was created nearly 50 years ago, rural electric cooperatives were established to operate in areas where the utilities could not or would not serve. In many instances such is still the case today. In large measure, rural utility cooperatives serve thinly populated territories. These rural utility systems financed by REA operate approximately 50 percent of all distribution line in the United States but only serve 10 percent of the Na-

tion's consumers. The average rural utility cooperative's investment per consumer is 162 percent of the average power company's investment.

These factors and others combined with higher utility construction and operating costs have contributed to the difficult financial and economic conditions in which electric cooperatives now operate.

H.R. 3050 is designed to preserve and maintain the REA loan and loan guarantee program, so vital to the continued financing of rural utility cooperatives. We in the bank cooperatives system are supportive of these provisions.

As I indicated earlier, both the farm credit system and our rural utility cooperatives are being forced to do business in an increasingly complex and quickly changing environment. The amendments to the REA Act contained in H.R. 3050 provide the means for the BC system to continue to develop its role as a provider of supplemental credit to rural utility cooperatives.

Additionally, this legislation preserves mutually beneficial relationships that have developed over the years between the Rural Electrification Administration, rural utility cooperatives, and the Bank for Cooperatives system.

By the end of 1982, system loans outstanding to rural utilities amounted to \$1.3 billion. This loan volume has been consistent in its growth, and the REA guarantee program has provided the system its primary entry into REC financing.

The lending programs developed by the BC system were developed to complement the dominant lending roles provided by REA and the Federal Financing Bank. There are some who argue, and I believe rightfully so, that were it not for the continued involvement of the Rural Electrification Administration in the rural utilities lending program, the Banks for Cooperatives' lending for rural utilities would be greatly diminished. I am pleased, therefore, to note that H.R. 3050 both recognizes and preserves the role of REA in rural utilities cooperatives financing.

While we in the BC system are generally supportive of the provisions of H.R. 3050, we would like to take special note of that provision relating to lien subordination and accommodation. We are pleased that H.R. 3050 clarifies the authority for REA to subordinate its first lien on the property and revenue of its borrowers. For years, REA was the exclusive lender to rural utility cooperatives, and its standard mortgage contracts naturally included a first lien on assets of its borrowers. However, as newer supplemental sources of financing were being developed, a perhaps inevitable conflict has developed between the Government's desire to reduce rural electric borrowers' reliance on REA and its continued reluctance to diminish its security interests in the assets of its borrowers. We believe that the clarification of the authority for REA to either subordinate or accommodate the security interest of supplemental lenders such as ourselves would more than likely encourage an increased flow of investment capital.

Mr. Chairman, I am pleased to have had this opportunity to offer this testimony on behalf of the Banks for Cooperatives and would be available for your questions.

Thank you.

[The prepared statement of Mr. Swackhamer appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Swackhamer, for a very fine statement. We do appreciate your presence here and your interest in being here today.

Now that concludes the witnesses, unless there is someone else in the audience who has a statement they would like to make.

At this point I would like to ask if there is someone who has been overlooked or if there is someone in the audience who would like to make a statement.

If not, will all of the witnesses who have been heard this morning please return to the witness table? You are going to be a little crowded, but we can shift the microphones to you. We will do all the questioning at one time.

I would like to ask all the members of the subcommittee, if they possibly can, to remain because there is a decision that must be made upon the completion of the questioning this morning as to what we do about a markup.

Mr. Partridge, Mr. Lewis, Mr. Vann, Mr. Davenport, Mr. Clapp, Mr. Feragen, Mr. Gill, Mr. Edmiston, Mr. Smith, and Mr. Swackhamer—I don't think I have overlooked anyone. If I have, I apologize, and you can come up anyway.

Again, I do want to say to each of you that we appreciate more than you know the very fine statements that you have given us today, the very good information that is obtained in these copies of the testimony that you are leaving with us, and we will give them our very best as we try to mark up a bill.

Now I yield to Mr. English 5 minutes for questioning.

Mr. ENGLISH. Thank you very much, Mr. Chairman. I will try to be brief.

Mr. Partridge, I made a point yesterday that it appeared to me in discussions that we had with regard to the transfer—that that is what we are doing; there is a paper transfer here within this legislation allowing the REA to continue to use the \$7.5 million we have had in the past and which still belongs to Uncle Sam. It belongs to the U.S. Government. It does not matter. You are simply transferring it from one pocket to the other. That is what we have done in the past. With this legislation, the REA, in 1993, is to begin paying back that money over a 24-year period, and we are simply saying, "Well, go ahead and keep using it," as opposed to paying it back. I believe that would break out somewhere in the neighborhood of a little less than \$400 million a year that is scheduled to be paid out over that 24 years.

Is this a correct interpretation of the reality of what we are looking at here—just a question of what pocket Uncle Sam is going to have the money in, whether it is going to be in the REA pocket or the Treasury pocket?

Mr. PARTRIDGE. You are exactly correct, Mr. English. The Revolving Fund is the property of the U.S. Government and would remain the property of the U.S. Government under the terms and provisions of this bill.

As you also correctly stated, with respect to the retention of the capital—the capitalization of the Revolving Fund—it would simply retain, rather than have paid out the assets of the Fund as the

notes held by Treasury on REA become due beginning in 1993. This bill would allow retention and capitalization of these assets in the revolving fund. Moreover, it would still remain the property of the Government.

Mr. ENGLISH. I must say, I am really at a loss. I tried to make a point yesterday with the Administrator, Mr. Hunter, concerning the use of the terms "giveaways" and "forgiveness." I really do not understand how this could be characterized as such, even with the wildest stretch of a person's imagination—if it belongs to the U.S. Government, no matter which Government agency it is with, it still belongs to the U.S. Government. That does not change.

Mr. Hunter has admitted that the money being loaned to the REC's must be paid back. The same thing is true with rural telephones. There is no forgiveness. There is no giveaway.

Can you understand how in the world the Administrator could characterize the provisions of this legislation in that manner?

Mr. PARTRIDGE. I really cannot, Congressman English. I would add that the term "bailout" has sometimes also been used. None of these terms apply to this legislation, nor to the rural electrification program as it would continue after the enactment of this legislation.

There is, indeed, no forgiveness of the indebtedness by the borrowers, and there is no change at all in their obligations toward repayment of principal or interest, for either electric or telephone. It will be repaid within the time agreed upon under the contract.

I cannot rationalize the use of terms such as "forgiveness," "bailout," "windfall," or any other such terminology with respect to what this bill provides.

Mr. ENGLISH. There have been several members of this committee who have been quite concerned and have tried to deal with the problem of the deficits the Federal Government is facing. I think we are very sensitive to any types of issues that might have an impact on that deficit.

I feel a certain degree of concern that in 1993 we may have this problem of not transferring from one bookkeeping department in the Federal Government to another bookkeeping department in the Federal Government, from the REA in the Department of Agriculture over to the Department of the Treasury. But, even stretching that to the point saying, "Well, the Treasury is not receiving it. It does not matter if another branch of the Government has the money. The Treasury does not have it, and the Treasury has to mark that up," that is still less than what we forgave the Government of Egypt last year and the year before in loans.

Is that your understanding?

Mr. PARTRIDGE. Yes, and there is, Congressman, no parallel whatsoever between the operation of the Rural Electric and Telephone Revolving Fund, on the one hand, and the actual forgiveness of some loans which have been made under the foreign assistance programs. The latter are, indeed, forgiven. No such thing occurs in the case of the REA program.

Further, as Congressman Stenholm noted yesterday, this legislation does not require any additional or new Federal outlays, none whatsoever. It does not change the input requirements of the Federal Government at all, as Congressman Stenholm noted.

Mr. ENGLISH. It seems strange to me, Mr. Chairman, that we would have this emphasis on forgiveness in this case—that is, making it appear that one branch of the Federal Government is forgiving another branch of the Federal Government—but there is no such emphasis placed on the true and genuine forgiveness of loans to a foreign government. I was hopeful we had put that to rest, and I have got to say that I was very disturbed to hear that kind of characterization by the Administrator, particularly in light of the ratios of individual-owned cooperatives and public utilities and the benefits that are provided to them as well as the REA.

I simply wanted to underscore that, Mr. Partridge. As I said, I am not sure it disturbed anyone else, but it did disturb me. I was disappointed to hear that testimony.

Mr. PARTRIDGE. Congressman English, if I may, I think it has, indeed, misled a lot of people. I think that much of the inaccuracy in the print media with respect to this proposal traces to these very allegations, which simply are unsupportable. They cannot be substantiated by any stretch of the imagination, as we see it.

Mr. JONES of Tennessee. The time of the gentleman has expired. Thank you, Mr. English.

The gentleman from Missouri, Mr. Coleman, is recognized for 5 minutes.

Mr. COLEMAN. Pursuing that line of questioning, I would like to ask Mr. Edmiston, who is an investment banker from Wall Street, this question:

You have just heard this conversation with Mr. Partridge and Mr. English. Do you totally agree with that conclusion?

Mr. EDMISTON. I am not totally familiar with the relationship between the CBO's and the loan program to offer you an enlightened comment on that.

Mr. COLEMAN. You do not know the relationship between the \$7.9 billion that we are being asked to transfer or I want to say forgive, but I am not sure what exactly we are doing with it. It is to turn it from a debenture to a stock situation, capitalize it—I guess that is the nicest way to say it. You are not familiar with that?

Mr. EDMISTON. Congressman Coleman, I would be happy to comment on that if I felt that I were knowledgeable with respect to those particular relationships, but I have not personally studied them in a sufficient degree to offer you a judgment on them from my perspective.

Mr. COLEMAN. You do not have any dealings in your professional relationship with your investment firm in this area?

Mr. EDMISTON. Well, I think the question that you are asking me, sir, relates to the relationship of the REA Revolving Fund and the borrowing through the Treasury by issuing certificates of beneficial ownership, and how that relationship is going to change under this proposed legislation. I just repeat that I am not familiar personally with those relationships in a manner that can give you a judgment. Sorry.

Mr. COLEMAN. I suppose I am asking for assistance. You are an expert witness.

Are we going to increase the size of the deficit or are we not under this bill?

Mr. EDMISTON. I have not studied whether it will or will not increase the size of the deficit. I understand from hearing others speak that it will not increase the size of the Federal deficit.

Mr. COLEMAN. Therefore, Wall Street would not react to this as an acceleration of higher interest rates, as a result of any action we might take on this bill?

Mr. EDMISTON. I would say that that is probably correct.

[Additional letter follows:]

Lehman Brothers Kuhn Loeb
Incorporated

55 Water Street
New York, N. Y. 10041

October 12, 1983

Honorable E. Thomas Coleman
 2344 Rayburn House Office Building
 Washington, D.C. 20515

Dear Mr. Congressman:

I have been informed that I misunderstood the thrust of the question you directed to me regarding the provision of H.R. 3050 which proposes to convert the notes that the REA Administrator has given to the Treasury in the amount of \$7.9 billion into equity capital of the Revolving Fund. It is my understanding that these notes represent the borrowing by the REA Administrator from the Treasury to provide funds for loans made by him during the period 1953 until the Rural Electric and Telephone Revolving Fund was established under the 1973 amendments to the Rural Electrification act.

As I recall, your question related to the impact that this action would have on the national debt and on the view the investment community might take if this provision were enacted into law. I am informed that should no change whatsoever be made in this provision, beginning in the year 1993 the revolving fund will be called upon to repay to the Treasury the note signed by the REA Administrator in 1953 in the amount of \$81,412,299. In each calendar year, the revolving fund would be required to repay the amount represented by the note then due. This procedure would continue until the full amount of these notes has been paid off. (See attached schedule of notes.)

The investment community is indeed concerned about the deficit. Particularly, the anticipated deficits approximating \$200 billion annually in 1984-1986. As the economy recovers the extraordinarily large financing requirements of the government will limit the availability of credit to business and consumers. This will lead to a more modest recovery than otherwise would occur as both the absolute and real level of interest are likely to remain high.

Since the national debt at September 30, 1983 totaled \$1.377 trillion and by the year 1993 could be significantly higher, it is quite unlikely that the return of the amounts listed in the note schedule for each year beginning in 1993 would, in each of the subsequent years, have any significant impact on the then outstanding debt of the U.S. Government.

The purpose of this provision of H.R. 3050 is to make these notes permanent equity of the revolving fund. The fund is an asset of the U.S. Government and the action proposed by the legislation would make no change in this status. This asset at some time in the future could be liquidated. This could occur in the event that Congress decides to diminish or discontinue authorizing Federal Government financing for the Rural Electric and Telephone programs. In that event repayment of outstanding loans would liquidate the revolving fund and the proceeds could be applied to reducing the national debt.

In this instance, it is clear that unless corrective action is taken in the near future, the Rural Electric and Telephone Revolving Fund will face financial difficulty within the next few years. The investment community through National Rural Utilities Cooperative Finance Corporation and the supplemental financing program has a substantial investment in the rural electric program. Any action, such as that proposed in H.R. 3050, assuring the long-term financial integrity of these enterprises would be consistent with and reinforce the effort to attract private market capital into the program.

Sincerely,



Robert R. Edmiston

Att.

bcc: Mr. Ira Shesser

REA DIRECT LOAN OBLIGATIONS TO THE U. S. TREASURY

NOTES PAYABLE MATRICES
TRIAL BALANCE
AS OF December 31, 1960

Long Term Notes

Note No.	Date of Note	Maturity Date	Face Amount of Note	Advances	Unadvanced Balance	Principal Payments	Unpaid Principal Balance
1-30	Paid in full	6-30-93	2,741,236,718.00	2,741,236,718.00	-0-	2,741,236,718.00	-0-
31	8-14-53	12-31-93	202,500,000.00	202,500,000.00	-0-	-0-	81,412,298.68
32	5-21-54	6-30-94	38,000,000.00	38,000,000.00	-0-	-0-	38,000,000.00
33	7-12-54	12-31-94	210,000,000.00	210,000,000.00	-0-	-0-	210,000,000.00
34	5-19-55	6-30-95	35,000,000.00	35,000,000.00	-0-	-0-	35,000,000.00
35	7-6-55	12-31-95	235,000,000.00	235,000,000.00	-0-	-0-	235,000,000.00
36	7-17-56	6-30-96	269,000,000.00	269,000,000.00	-0-	-0-	269,000,000.00
37	4-4-57	12-31-96	25,000,000.00	25,000,000.00	-0-	-0-	25,000,000.00
38	4-23-57	12-31-96	200,000,000.00	200,000,000.00	-0-	-0-	200,000,000.00
39	8-21-57	6-30-97	209,000,000.00	209,000,000.00	-0-	-0-	209,000,000.00
40	3-6-58	12-31-97	10,000,000.00	10,000,000.00	-0-	-0-	10,000,000.00
41	7-8-58	6-30-98	384,500,000.00	384,500,000.00	-0-	-0-	384,500,000.00
42	1-27-59	12-31-98	25,000,000.00	25,000,000.00	-0-	-0-	25,000,000.00
43	7-16-59	6-30-99	215,000,000.00	215,000,000.00	-0-	-0-	215,000,000.00
44	1-15-60	12-31-99	25,000,000.00	25,000,000.00	-0-	-0-	25,000,000.00
45	7-5-60	6-30-00	190,000,000.00	190,000,000.00	-0-	-0-	190,000,000.00
46	1-11-61	12-31-00	30,000,000.00	30,000,000.00	-0-	-0-	30,000,000.00
47	3-14-61	12-31-00	30,000,000.00	30,000,000.00	-0-	-0-	30,000,000.00
48	5-10-61	12-31-00	60,000,000.00	60,000,000.00	-0-	-0-	60,000,000.00
49	9-7-61	6-30-01	307,500,000.00	307,500,000.00	-0-	-0-	307,500,000.00
50	5-1-62	12-31-01	70,000,000.00	70,000,000.00	-0-	-0-	70,000,000.00
51	2-7-63	12-31-01	380,000,000.00	380,000,000.00	-0-	-0-	380,000,000.00
52	6-10-63	12-31-01	25,000,000.00	25,000,000.00	-0-	-0-	25,000,000.00
53	3-3-64	12-31-03	345,000,000.00	345,000,000.00	-0-	-0-	345,000,000.00
54	9-18-64	6-30-04	338,000,000.00	338,000,000.00	-0-	-0-	338,000,000.00
55	5-18-65	12-31-04	97,000,000.00	97,000,000.00	-0-	-0-	97,000,000.00
56	11-23-65	6-30-05	387,000,000.00	387,000,000.00	-0-	-0-	387,000,000.00
57	5-25-66	12-31-05	15,000,000.00	15,000,000.00	-0-	-0-	15,000,000.00
58	6-29-66	12-31-05	51,529,769.00	51,529,769.00	-0-	-0-	51,529,769.00
59	1-16-67	12-31-06	447,000,000.00	447,000,000.00	-0-	-0-	447,000,000.00
60	6-28-67	12-31-06	15,000,000.00	15,000,000.00	-0-	-0-	15,000,000.00
Total	Carried Forward		7,612,266,487.00	7,612,266,487.00	-0-	2,862,324,419.32	4,749,942,067.68

NOTES PAYABLE LEDGER
TRIAL BALANCE
AS OF December 31, 1980

Long Term Notes		Quantity	Face Amount of	Advances	Unadvanced	Principal	Unpaid Principal
Sl. No.	Date of Note	Date	Note		Balance	Repayments	Balance
Balance Brought Forward				7,612,266,487.00	-0-	2,862,324,419.32	4,749,942,067.68
61	2-15-68	2-31-07	434,600,000.00	434,600,000.00	-0-	-0-	434,600,000.00
62	10-9-68	6-30-08	449,000,000.00	449,000,000.00	-0-	-0-	449,000,000.00
63	12-17-69	6-30-09	463,300,000.00	463,300,000.00	-0-	-0-	463,300,000.00
64	2-3-71	2-31-10	465,000,000.00	465,000,000.00	-0-	-0-	465,000,000.00
65	9-21-71	6-30-11	644,100,000.00	644,100,000.00	-0-	-0-	644,100,000.00
66	3-19-73	2-31-12	201,896,605.00	201,896,605.00	-0-	-0-	201,896,605.00
67	5-3-74	2-31-13	594,000.00	594,000.00	-0-	-0-	594,000.00
68							
69	11-18-76	2-31-16	455,509,395.00	455,509,395.00	-0-	-0-	455,509,395.00
TOTAL				10,727,066,487.00	-0-	2,862,324,419.32	7,864,742,067.68
The short term note dated 3-31-76 is not included in this report.							
Signed: <i>B. Thompson</i> Head, Collections & Custodial Section							
The totals of columns 3, 4 and 5 of the trial balance agree with the General Ledger Accounts 0050, 0050, 2010 and 0054 respectively.							
Signed: <i>James H. H. Vener</i> Head, Fiscal Control Section							
Date: 3-24-81 Date: 4/14/81							

Mr. COLEMAN. Yesterday we had the Administrator here, who stated on the record that for every 1-percent increase in the interest rate in the Revolving Fund there is passed on to consumers a one-half cent per day increase in their electric bills. Can any of you refute that as an average figure?

Mr. PARTRIDGE. Congressman Coleman, I will attempt to deal with that. However, before I get to it, if I may, I would like for your question to be addressed to Mr. Guy Lewis, who manages a very substantial rural electric cooperative, the Rappahannock Electric Cooperative, headquartered at Bowling Green, Va. He knows precisely what the impact would be because he has measured it. Would that be agreeable to you? I will be happy to provide you with some national figures after Mr. Lewis' response.

Mr. COLEMAN. As long as I have time for him to answer.

Mr. LEWIS. Mr. Congressman, in our calculations this morning, in my particular system if we were paying 9 percent instead of 5 percent I believe 9 percent was the suggested figure in the Administrator's testimony—an additional 4 percent on the loans since 1973, not going back and including the 2 percent loans, it would cost our particular system an additional \$1,150,000 per year, which works out to approximately 8 cents per day, for a 4-percent increase.

Mr. COLEMAN. I think it would be 2 cents per day for what the Administrator said.

Mr. LEWIS. That is right.

Mr. COLEMAN. Yours would be 8 cents per day.

Mr. LEWIS. He used an average. He addressed it as an average consumer. I do not know what an average consumer is, but this is the way it works out per consumer with my 41,000 or so consumers.

Mr. COLEMAN. OK. Well, I guess what I am asking is for the association to respond because we have people such as you who are 8 cents per day, and yesterday we heard from a telephone company which indicated a \$3-per-month difference, and so forth.

I think it is an important point because the people who are going to attack this piece of legislation are going to do so on the basis that we are talking about \$7.30 a year on a consumer's bill. I would like to have a response from the association. I understand it is an average and I understand some will be very high and perhaps some will be very low, but I need that information.

Mr. PARTRIDGE. Yes, and I will be glad to respond on that.

With respect to the average size loan last year, which was about \$2.5 million during fiscal year 1983, if you assume a 9-percent interest rate rather than the 5 percent, and take into account the times interest earned ratio which must be complied with, it would result on the average for each consumer, in an increase of a little over \$19, \$19.31, for that 1 year alone and for interest alone. That is in 1983. That does not sound like very much, but that is 1 year. When you compound this year by year, in each succeeding year it gets to be a tremendous burden.

As witnesses pointed out this morning, and particularly in the case of generation and transmission systems as former Administrator Feragen pointed out, in their case the average consumer's bill at present, at the interest rates which currently exist include a 30-

percent component consisting of interest expense. Thirty percent of the consumers' bills served by their generation and transmission systems through their distribution cost is interest expense. That, of course, is the result of years of borrowing at rates much lower than the Administration is proposing be applied.

I am not really sure what interest rate they would insist be applied. It was not made clear.

Mr. COLEMAN. If my colleagues would permit me one more question, to follow up on this, under this bill we are actually talking about an increase from 5 to something else, too. Could you give me the figures as to what the increase would be to the consumers under this proposal?

Mr. PARTRIDGE. I really am not prepared on that. I certainly could calculate it. We would be glad to calculate it.

The problem is that there are a lot of variables involved here, including the level of the loan program.

Mr. COLEMAN. I think we have to assume a 1983 situation, just freeze it and use that as a basis, which is what the Administrator did yesterday, and which your figures then reflect.

Mr. PARTRIDGE. While other questions are being pursued, if we may come back to this, Mr. Chairman, we will do a little calculating while the questioning is proceeding.

Mr. COLEMAN. Fine. Thank you.

Mr. JONES of Tennessee. We will move to another Member at this time. The Chair recognizes Mr. Stenholm for 5 minutes for questioning.

Mr. STENHOLM. Thank you, Mr. Chairman.

My first question will be asked to one of the gentlemen that is not there. If Mr. Hamil were here, I would have asked him, but I will take leave of asking my question and responding by what he said in his statement, because I think it is very pertinent to the question Mr. English asked and that Mr. Coleman asked.

On Tuesday night I heard President Reagan make one of the finest speeches that I have heard him make since he has been President. In that he stated that voters do know that the future of freedom depends not on what is in it for me, but on the ethic of what is good for this country.

My question of Mr. Hamil would have been, do you believe that H.R. 3050 meets that criteria? His answer is, and I quote, and I am taking it out of context but I think it serves the point that both of my colleagues have made before me. Mr. Hamil says:

I personally am satisfied that the recommendations which this study committee developed and which are contained in large measure in H.R. 3050 are both reasonable and fair to the REA borrowers and to the Nation as a whole.

That is the purpose for which we are here in the hearing, and I think that answer is one that goes better to explaining some of the controversy surrounding this bill.

Mr. Partridge, section 6 in the bill provides a new interest rate formula. The Administration claimed yesterday, as we understand it, that the formula would not permit REA to take into account all interest costs associated with the Fund. Thus, the Administration appears to say that the allowable interest rate and the interest

income would not be sufficient to balance all interest costs on all outstanding borrowings. Is this criticism valid?

Mr. PARTRIDGE. No, Congressman Stenholm, it is not. Certainly that is not our intent, nor do I read the bill as saying that.

However, as you say, REA did so interpret the bill, and so stated yesterday.

That is not correct, as we understand it. It has been our intent always that the changes which are made in the act will enable the REA Administrator—in fact, will mandate him—to set an interest rate sufficient to balance all interest costs on all outstanding borrowings.

Mr. STENHOLM. If I understand your answer, you believe the bill's language would allow the rate to be set high enough to produce interest income adequate to offset all interest costs?

Mr. PARTRIDGE. Yes, sir, that's absolutely correct.

Mr. STENHOLM. Then you would have no objection to an amendment clarifying that the rate shall be sufficient to balance interest income with interest cost on all outstanding obligations?

Mr. PARTRIDGE. No objection whatsoever. If the language can be interpreted, incorrectly then it should be clearly stated so that no misinterpretation is possible.

Mr. STENHOLM. Would any other gentleman at the table have any objection to the colloquy that I have just had with Mr. Partridge?

[No response.]

Mr. STENHOLM. Mr. Edmiston, in your testimony on page 6 you referred to TIER, "times interest earned ratio," and in light of Mr. Coleman's question, would you elaborate a little further on the significance of the 802 CFC members' TIER's being 2.16 contrasted to 2.9 times for the larger investor-owned utilities?

Mr. EDMISTON. To look at it in a sense of protection for investors, in terms of their making an investment in a debt obligation of a rural electric cooperative, it is a very important measure of the ability of the entity to service that debt over a period of time.

Now understand that in the rural electric cooperative industry when we are looking at the distribution cooperatives' coverage of interest we separate generation from distribution, and we are looking at the coverage of interest at the distribution level. That is a measure of being able to demonstrate to an investor the financial strength of that distribution member and his ability to pay the interest on his indebtedness. In contrast to an investor-owned utility, we must appreciate that investor-owned utilities do not separate generation and distribution.

Generally speaking, the coverage for investor-owned utilities has been a little bit higher as a matter of tradition than it is in the rural electric cooperative program. Nonetheless, as I point out in my testimony, the ratio of interest coverage has declined over the past 7 or 8 years in the rural electric program.

I further pointed out that that level is getting close to the level of discomfort for investors. I further noted that the decline in this ratio has been arrested as a result of the efforts of the REA and CFC over the past couple years to educate their members about the importance of adequate interest coverage. Hopefully, that decline

has been arrested and will stabilize and perhaps improve in coming years.

Mr. JONES of Tennessee. The time of the gentleman has expired.

Now the Chair recognizes Mr. Skeen for any questions he might have.

Mr. SKEEN. Thank you, Mr. Chairman.

I want to tie up a loose end here and ask a question of Mr. Partridge.

The REA Administrator was in here yesterday with something like 100 computer runs that they had done on this cost analysis. I am sure that you have some, too. I think this is what we were referring to earlier. However, inasmuch as I came in on the tailend of the conversation—it is my understanding you are going to make these runs of yours available so that we can make comparisons?

Mr. PARTRIDGE. Congressman Skeen, we would be glad to do that. We do not have them with us this morning, but we have, of course, priced out the formula under this bill. We do, indeed, verify that it will sustain the Revolving Fund; that if the interest rate is set so as to meet the interest expense of the Fund, which is what the bill requires, then certainly the Fund shall remain in balance.

Now we have not seen—we are not familiar with and did not know until yesterday of the computer runs made by REA. Therefore, I really cannot address those features.

One thing that I did note from the footnotes of the table attached to the REA Administrator's testimony was that they assumed that the notes held by Treasury against REA on the loans made in 1972 and earlier years would be repaid. The footnote clearly indicates that. That, of course, will create an insolvency in the Revolving Fund, and that is precisely what this legislation is intended to remedy.

Mr. SKEEN. I would be interested, if you have those kinds of runs, or at least a critique of the comparison. If you would make that information available to us, we would appreciate it very much.

Mr. PARTRIDGE. We would be glad to do so, of course.

Mr. SKEEN. I would like to ask former Administrator Clapp—when you were Administrator of REA, did you not pay off notes that were signed by previous Administrators, and did you expect to pay off those notes that you had signed?

Mr. CLAPP. I think the obligation of REA to pay off those notes under present law is clear, and has been performed. Unless Congress decrees some different arrangement, as is proposed here, it would have to be performed in the future.

Mr. SKEEN. Thank you, Mr. Clapp.

I would like to ask former Administrator Feragen—did you anticipate the \$7.9 billion in long-term notes that REA owed to the Treasury would not be repaid?

Mr. FERAGEN. Mr. Congressman, I do not think we anticipated they would not be paid. We did recognize very early after I took office the problem that this legislation addresses, and I brought it to the attention of the NRECA.

At the time that we were issuing CBO's, the interest rates were 12.5, 13, 14 percent, and that exacerbated the very situation that we confront today, but we never anticipated that those notes would not be paid from the Revolving Fund.

Mr. SKEEN. Also, were the minimum limiting levels that Congress set ever exceeded during your time as Administrator?

Mr. FERAGEN. In my memory, no, sir.

Mr. SKEEN. Did you anticipate—if so, what would have been the impact on the Revolving Fund, if it had ever occurred?

Mr. FERAGEN. Do you mean if we had loaned less than authorized by—

Mr. SKEEN. If you had exceeded the minimum.

Mr. FERAGEN. We exceeded the minimum, and I think it was usually said from \$800 million to \$1.1 billion. I think in almost every year we were very close to the maximum.

Mr. SKEEN. But you did not exceed it?

Mr. FERAGEN. We did not exceed the maximum.

Mr. SKEEN. Thank you very much.

In connection with this, Mr. Chairman, may I ask you a question?

I have the understanding that there are still four reports that we have not received from the Inspector General, the General Accounting Office, the Congressional Research Service, and the Congressional Budget Office. Have we received any of these reports? If we have not, will we be in receipt of them before we go to markup?

Mr. JONES of Tennessee. Joe, the only one we requested is the one from CBO.

Mr. SKEEN. Well, there are three other reports, as I understand it.

Mr. JONES of Tennessee. We have not made a request for those.

Mr. SKEEN. Someone is doing them. One is an examination of operational management of REA and the rural electrification cops from the Inspector General, and one from the General Accounting Office that deals with analysis of the provisions of H.R. 3050. Then there is also one from the Congressional Research Service examining H.R. 3050 for cost and feasibility. There is one from the Congressional Budget Office which is the cost analysis, and so forth, and commentary on it.

I wonder, could we get those, Mr. Chairman?

Mr. JONES of Tennessee. All I can say is that we can try.

Mr. SKEEN. If they are complete or what stage they are in—

Mr. JONES of Tennessee. I do not know what stage they are in. I could not answer that.

Mr. SKEEN. I would like to make that request, if it is not out of line.

Mr. JONES of Tennessee. Counsel might know. They were not initiated by us in the first place.

Mr. SKEEN. Well, I, for one, would like to see them if they are anywhere near the stage of completion that we can get them in a timely fashion.

Mr. JONES of Tennessee. We could ask.

Mr. SKEEN. Thank you, Mr. Chairman.

Thank you very much for the responses.

Mr. JONES of Tennessee. The Chair now recognizes Mr. Tallon for 5 minutes of questioning.

Mr. TALLON. I have no questions, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Tallon.

The Chair recognizes Mr. Daschle for 5 minutes.

Mr. DASCHLE. Thank you, Mr. Chairman.

I want to address my questions, at least initially, to Bob Feragen. I was not here, Bob, to hear your statement. I have read it. I am very impressed by some of the remarks you make.

In particular, what you say on page 6—as everyone knows, in the Dakotas and some of the more rural areas we have a very grave concern about the future of special interest loans, special rate loans. I would be interested in your view as Administrator now, as we look to the future, to H.R. 3050, and maybe for the record you could just, in a very brief way, elaborate on why you think special rate loans are still important, even though we may have gone through a period when those were more of a mainstay. Why do they still carry a great deal of importance, in your opinion?

Mr. FERAGEN. Congressman Daschle, we have, as you well know, systems in the more populated eastern part of South Dakota that serve less than one consumer per mile of line. These are family farms. We are not talking about one oil well per mile of line. We are often accused of having nothing but oil wells at these low densities.

It is exceedingly difficult for these systems to keep a competitive stance in their rates when they have to build and maintain a system that is so far stretched and with usages that have been declining. We have found in the past 3 years, as a system as a whole in eastern South Dakota, that we have virtually had no load growth, and yet on the basis of figures 10 years ago, on which we built powerplants, we now have to bear the cost of those new facilities coming into being.

Therefore, in my mind the special interest rate ought to be mandatory, at least from the point of view that Congress ought to say, "It is our intention that those systems that really need it," and then define that criteria. I think the criteria that is drafted in the bill is reasonable. It might be massaged to try to be a little more accurate. However, some systems do need this kind of special assistance.

It seems to me in the same sense that we have a Revolving Fund subsidized interest rate for the whole program, that to recognize, as we did since 1935, that some systems really serve very difficult geographical areas, I think it is fully justified, if you just consider the job they have.

We are not asking this to enrich individuals. These are for rural communities that this assistance is happening. It is not for the general manager's fund, as is sometimes said.

Mr. DASCHLE. I intend to offer an amendment along those lines when we get to markup. I would be interested, from your experience as an Administrator, can you see times when obviously we have had discretionary determinations in the past—has that discretion failed to serve the need of some of our situations in the past? Could you give us a good example of where that may have happened?

Mr. FERAGEN. I know of two instances where there has been extensive storm damage, which is one of the criteria in the draft bill, something like 500 miles of line. Obviously, the system is in dire need, having to call upon numerous systems to come and help them. They come to REA to refinance, to rebuild that line, and

they have been refused 2 percent loans. This is a system that serves approximately one consumer per mile of line.

I think in that kind of extremity it ought not to be a question. That system and its directors ought not to have to come to Congress and lobby you for the kind of obvious help which that sort of disaster signals.

I would say, yes, I know of at least two cases in the past 2 years where that has happened.

Mr. DASCHLE. We had that case clearly on record, I think, at one of the earlier hearings, about a year ago. I think that is an excellent case in point.

It could be argued, too, that it is in the interest of the whole system that special rate borrowers are kept viable, that those who live in these lightly populated, very rural areas are given an adequate opportunity to participate in the program.

What would happen, in your opinion, if 1 percent of the principal and interest payments into the electrification and telephone accounts was reserved to cover the cost of the accounts of special rate borrowers? What, in your opinion, would be the effect of that on a standard rate borrower?

Mr. FERAGEN. I think it would be a minuscule effect. I have not calculated it. I think we could provide that for the record, but we are talking about just taking 1 percent of the repayments each year, putting them in a special fund, and I do not think in the long run it may be adequate for the needs of the specials. There is provision in the draft bill that would come back to this committee and to Congress and say, "If there is a need there, would you appropriate funds?"

I think we have clearly seen in the experience of this program that the need for really low, low-interest rates like 2 percent or, as it is said in the bill, half of the regular rate has diminished greatly. I think we hope that it would be diminished greatly.

There is a provision that every 5 years the Administrator would look at the loan. If the system did not qualify, they would automatically be at the regular rate at the time that loan was made. That seems immanently fair, and it leaves it to Congress to continually look at the need. I think that is fair, too, because if the system does not need or deserve it, then they ought to go back to the regular rate.

Mr. DASCHLE. Thank you very much, Bob.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Tom.

Before we take another round of offering members of the subcommittee the opportunity to ask questions, I have a couple questions I want to ask.

Mr. Partridge, I have one for you.

The financing of the rural electric and telephone programs has evolved over the years from a rather small, direct Government loan program to a large sophisticated financing program with insured loans, supplemental loans, and guarantees. Would you, for the record, explain the difference in these loans and how the interest rates are determined?

Mr. PARTRIDGE. I would be glad to do so, Mr. Chairman.

The REA insured loan program makes funds available at an interest rate of 5 percent as a standard rate, with the exception that in unusual circumstances, such as Administrator Feragen just described, the Administrator does have the discretion to make loans at less than 5 but not less than 2.

Those loans typically are made available to the distribution cooperatives. They are used to finance the electric plant of distribution cooperatives.

Additionally, and this was made quite clear at the time Public Law 93-32 was being debated in the House of Representatives, both in the committee and on the House floor, it was also the intention of the Congress that those insured loans be available to finance generation and transmission facilities. Now, in practice, very little of the money under the insured loan program has been made available for power supply facilities.

The guaranteed loan program is just that. It is a guaranteed loan program. Incidentally, I should note that the insured loan program is run wholly out of the Rural Electric and Telephone Revolving Fund. That is the source of its money and has been from 1973.

The guaranteed loan program, by contrast, is a program under which REA guarantees bulk power supply facilities, generation and transmission cooperatives. The funding for those loans has from the outset, under arrangements made by Administrator Hamil with the Treasury and the Federal Financing Bank, been funded through the Federal Financing Bank. Those loans bear an interest rate equal to whatever the Federal Financing Bank pays to raise the money, plus one-eighth of 1 percent, which is a brokerage fee, if you will, to the Federal Financing Bank, plus a small fee—I think one-thousandth of 1 percent—paid to the Treasury by REA, paid to the Federal Financing Bank by REA. No, it is the other way around. I am sorry. The Federal Financing Bank reimburses REA a fraction of a percentage point for the servicing of those loans.

As a consequence, the guaranteed loans have borne very high interest rates, as rates have been high, particularly in the past 5 or 6 years.

The generation and transmission systems have borrowed at rates ranging, in my recollection, from about 9 percent to as high as about 16 percent. I would look to some of these other gentlemen to verify that, but I believe that is essentially the range. These are high-rate loans, and they do produce at the same time loans at interest rates lower than we could borrow elsewhere. They do make a small margin of profit for the Federal Financing Bank.

Mr. JONES of Tennessee. Then are you saying that the insured loans made from the Revolving Funds are the only ones that are paid out at a reduced interest rate?

Mr. PARTRIDGE. Yes, sir, Mr. Chairman, that is correct.

Mr. JONES of Tennessee. That is correct? Well, what percentage of the total program do these insured loans made at reduced rates occupy? Do you have that as a record? Do you know?

Mr. PARTRIDGE. Well, the loans for the year just closed, fiscal year 1983, the insured loan level I believe was right at \$850 million. The REA loan guarantees aggregated \$3,388 million. It is about 20 percent of the total loan volume going into the insured

loan program and about 80 percent of it into the guaranteed loan program.

Mr. JONES of Tennessee. Say that again. How much, Bob?

Mr. PARTRIDGE. About 20 percent of the total loans made by REA in fiscal year 1983 were for insured loans, and about 80 percent of their insured and guaranteed loans total was guaranteed.

Mr. JONES of Tennessee. You are saying about 20 percent of it?

Mr. PARTRIDGE. Yes, sir.

Mr. JONES of Tennessee. Thank you very much. I wanted to be clear on that. I thought that was correct or near correct, but I was not sure.

I see my time has expired, too.

The Chair recognizes Mr. Coleman for any questions that he might have.

Mr. COLEMAN. Thank you, Mr. Chairman.

Following up on my last question, Mr. Partridge, you and Mr. Smith have been working on some figures there as to what you anticipate the cost would be to the consumers under this bill.

Mr. PARTRIDGE. Yes, sir, Congressman Coleman. What we did was take last year, 1983, where the average loan, as you remember, was about \$2.5 million, and of course that was made at a 5-percent interest rate. If that rate had not been 5, as the law now provides, but instead had been a rate which REA yesterday said they believed would have been in place under the present legislation; namely, about 5.9 percent, then the increased cost in the bill of consumers, the average consumer, would have been, as we calculate it, \$4.34. That is not a great increase. It is a bit more than the REA had said.

It certainly does hold, as we think it must be held, to a minimum the increase in cost of service. This is one of the necessary features of this legislation. Indeed, the legislation, had it been in place for the fiscal year just ended, would have resulted in average increase in consumer bills for the year of about \$4.34 for the single year alone.

Mr. COLEMAN. You said that was based upon what Mr. Hunter said yesterday, figuring out the formula, and it would end up being a 5.9-percent interest rate? Is that correct?

Mr. PARTRIDGE. As we recall, yes, Congressman Coleman, I believe he said 5.9.

Mr. COLEMAN. That is right. That is what he has down here.

Now my next question is—Mr. Stenholm asked you a series of questions, and your response was that you understood that we are talking about all interest, not just annual interest. Mr. Smith is nodding in the affirmative.

If that is the case, then Mr. Hunter's figures are all wrong from yesterday, because his 5.9, which is the end result, which you just based that on, is based upon 1984 CBO interest expenses alone of \$400 million.

What would be the figure that you have to plug in here under your understanding and interpretation of this bill, instead of the \$400 million?

Mr. SMITH. Mr. Chairman, if you apply the formula which was in Mr. Hunter's testimony, 5.9 percent times the amount of borrowing produced \$65 million in interest expense. If you took the 5.9 per-

cent REA rate times the level of lending, \$1.1 billion, that also equates to exactly \$65 million.

The formula can work, even under their example, to produce income, interest income, equal to interest expense.

Mr. COLEMAN. Now wait a minute. For what period of time?

Mr. SMITH. Well, this is the initial year.

Mr. COLEMAN. All right, but Mr. Partridge said that we are talking about not just for an initial period of time, but to pick up all other interest.

Now my question is, what figures do you plug in here, and then what is your result in interest rate? It is not 5.9. It would have to be more, I assume, because you are picking up more past-due interest—

Mr. SMITH. I think the basic problem, REA in interpreting the formula did not apply the standard interest rate to cover all outstanding CBO's—

Mr. COLEMAN. That is right.

Mr. SMITH [continuing]. Under all circumstances. Our intent is that it would accomplish that.

Mr. COLEMAN. In order to translate your answer, you cannot disagree with them one time on how they interpret the section and then use their assumption on the interest rate later. You cannot have it both ways.

What I am asking is, based upon your understanding of the bill, what is the outstanding ending point, which is your interest rate? I am asking if you can compute it that fast, actually.

Mr. SMITH. Right now there is no problem because the outstanding CBO's are being met by interest income, and any borrowing, by their example, would be covered.

Now they apparently said that in the future there might be a problem, and I think the best way to resolve that is to make doubly sure that the Administrator can set the interest rate in that year, whatever year down the road, to cover all CBO interest expense. It must.

That is certainly the intent of the bill. Apparently, they have applied a very rigid interpretation to the formula that is not our intention at all.

Mr. COLEMAN. I am not quite sure. I think I understand what you said, but I am not sure you understand what I said.

When the Administrator was here and showed his page 2—and I know I have the advantage of looking at his little formula here—when he plugs in all these figures, he plugs in here anticipated 1984 CBO interest rate expense of \$400 million. Now if you disagree that we are not just talking about 1 year at a time but we are talking about lots of years before, I assume that \$400 would be increased under your assumption. If that is the case, how can you change the figures and still come out with the same answer?

Mr. SMITH. Because the \$400 million is accurate now. What we are saying is that, whatever that borrowing interest expense is, if it is \$600 million, if it is \$800 million, it has to be the total interest expense on total outstanding CBO's issued in any year for whatever purpose. If you plug that total amount in this formula, it will work.

They have applied the formula to indicate that it would not necessarily reflect the total interest expense. We are saying that it must.

Mr. COLEMAN. OK. Let me ask you one final question on this series.

What is your understanding of the total interest expense under this bill for 1984?

Mr. SMITH. It is about \$400 million.

Mr. COLEMAN. It happens to be the same?

Mr. SMITH. I think the \$400 million figure is accurate. It is of reasonable accuracy.

Mr. COLEMAN. I do not understand how it can be 1 year and disregard the past, but if you consider the past it is the same as the 1 year.

Mr. SMITH. The total outstanding CBO's are about \$3.5 billion times 11.4 percent interest. Whatever that works out to is the amount of interest that will be due during the current period.

Mr. JONES of Tennessee. The time of the gentleman has expired.

Mr. Stenholm, you are recognized for 5 minutes.

Mr. STENHOLM. Mr. Edmiston, again on page 6, you state,

Another measure of financial strength—the ratio of equity to total assets—has also declined. In 1972 CFC member distribution cooperatives equity as a percentage of total assets was 34 percent, in 1982 it was 28 percent.

Would you expound a little more on the significance of that in the financial community and how that would affect interest rates?

Mr. EDMISTON. We must be careful, Mr. Congressman, not to attach too much importance to any one particular measure of financial strength, but the ratio of equity to total assets is an important measure of financial strength for any enterprise. It will vary according to industry and according to the financial risk that the enterprise has to face and the business risk that the enterprise has to face in the conduct of its affairs.

The percentage of equity in the distribution members is one of the key financial ratios that one would observe in trying to understand the capacity of that distribution cooperative to meet its financial obligations. As we have pointed out, as a result of rather high interest rates over the past decade, the coverage ratios of the distribution cooperatives, as well as the coverage ratios in investor-owned utilities, have declined. Concomitant with that, that has resulted in decline in the ratio of equity to assets for distribution cooperatives in particular.

In my judgment, that is an important ratio and it is at a level that I would not like to see diminished. I think if it got lower, then one might question the financial capacity of distribution cooperatives to continue to meet the needs of attracting capital from the private capital market on relatively fair terms.

Mr. STENHOLM. Thank you.

Mr. Clapp, in regard to the question Mr. Daschle asked of Mr. Feragen, if you were to find yourself back in the position of Administrator of REA, would you prefer to have the Congress mandate the conditions under which the lower interest rates would apply for certain natural disasters and emergencies or would you prefer to

have it as we now have it, in which it is left to the discretion of the Administrator?

Mr. CLAPP. I think you have to be guided by what you feel are the dominant circumstances of the time. I am not familiar with the cases that Mr. Feragen and Congressman Daschle were discussing.

I can see that it is very possible that in the exercise of discretion REA and the REA Administrator may not perform in the full interest of preserving the viability of a given system under extenuating circumstances.

However, if you assume that REA is going to be sympathetic and compatible in its administrative stance with the interest and the mission of the program, then I would certainly say that the flexibility of discretion is more useful in fitting the financing requirements of the system involved to the terms of the loan.

However, if there is a feeling in the Congress that some insurance must be required that the Administrator will exercise his discretion in the full interest of the program, then obviously the standards have to be written in and performance has to be mandated on them.

Standards are difficult to come by that fit all conceivable situations.

Mr. STENHOLM. I thank you for that answer.

Mr. Partridge, according to at least one press report I have seen, the Revolving Fund's total interest expense already exceeds total interest income. Is this true?

Mr. PARTRIDGE. No, sir, Congressman Stenholm. That is incorrect.

Mr. STENHOLM. At what point in time is the best estimate that we will have the problem?

Mr. PARTRIDGE. As nearly as we can determine, and obviously having to make some assumptions, unless a change is made, the interest income of the Fund will fall short of the interest expense around 1986.

Mr. STENHOLM. Thank you.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Stenholm.

Mr. Skeen is recognized for 5 minutes.

Mr. SKEEN. Thank you, Mr. Chairman. I would like to yield my time to the distinguished gentleman from Missouri.

Mr. JONES of Tennessee. Mr. Coleman.

Mr. COLEMAN. Thank you, Mr. Skeen.

Following directly up on that, then, in 1986 you and the Administrator go your separate ways, diverge in your conclusions here, even based upon his assumption. Your revenues and your outgos, then, are not the same.

I understand right now, in answer to Mr. Stenholm's question, that you are in balance, let's say. You just got through saying for 1986 you are going to be unbalanced.

What happens after 1986? Can Mr. Smith give me a rough idea or a guesstimate as to how this interest rate would fluctuate during the next 3 years or, if you want to start in 1986, because that is when you see this thing coming to a head as far as income-outgo. Can you give me some rough estimates here as to what this

5.9 percent would do in those years, based upon your experience and knowledge and information that you have in the past?

Mr. PARTRIDGE. We certainly can do that if we make some assumptions. We will obviously have to do some crystal balling to do that, because we do not know, of course, what the economy will do, or what the drawdown on the Revolving Fund may be under the loan contracts outstanding. That really is what determines the need for the cash flow which occasions the issuance of the certificates of beneficial ownership. However, I guess we will try that.

Mr. COLEMAN. We have to have the same rules on all of these assumptions, and those were an 11-percent CBO rate, a no growth rate, no refinancing, and CBO's amortized. That is what he has on his assumptions as of yesterday. If you can play by those same rules, can you give me some sort of guess as to what this interest rate would be in the next 5 years. They obviously are going to fluctuate, but I am asking for a ballpark figure.

Mr. SMITH. We looked backward when we were doing the work for the committee. The rate would have had to have been as great as 8 percent had the legislation been in place several years ago. Now that was 2 years ago when interest rates peaked over the last 10 years. The CBO rate at that time was the highest. REA paid 15.3 percent on its CBO amount issued on September 30, 1981.

Obviously, interest rates have improved. That improvement, that reduction of CBO rate, would be reflected under our legislation in the REA interest rate.

Frankly, the REA interest estimate of 6 percent or 5.9 percent is not a bad guess currently, given the CBO rate of 11 percent, loan repayments of about \$900 million. The loan repayments will continue to increase slightly. We have information we could submit for the record. I believe it was requested yesterday as to loan repayments over the next few years. They will continue to increase slightly each year to exceed \$1 billion a year within the next couple of years.

The larger question, then, is what is the interest rate going to be. As you say, use 11 percent. If we did that, it would be fixed.

Loan advances have been down in fiscal year 1983 to about \$900 million for both programs. It is anyone's guess if that increases. It should increase as the recovery occurs to be about \$1.1 billion, equal to the level of new loan approvals.

Based on that level of approvals and 11 percent CBO rate, I think that we are looking at from 6 to 7.5 percent interest rate, standard interest rate, on REA financing.

Mr. COLEMAN. Is there going to be a flyup or a notch in 1986 because of the balance situation?

Mr. SMITH. Interest expense is not at all likely to exceed interest income in 1986, for some changes have occurred since the projection was made pertaining to 1986. An appropriation to the Revolving Fund is very likely this year. That will have a substantial benefit to the Fund.

Mr. COLEMAN. What year do you want to take, then, for when you get out of balance?

Mr. SMITH. The crossover? I think we are looking now at the end of the 1980's.

Mr. COLEMAN. Would there be a flyup then or a notch?

Mr. SMITH. As long as the CBO rate remains as high as 11 percent, there will definitely be a time at which the total interest income will not be as great as interest expense. I would think that would happen by 1990.

Mr. COLEMAN. Based upon that information, then, what would be—let's say 6 percent, which is 5.9, but let's just say 6 percent. You gave me a figure a while ago of increasing \$4.34 a year under the bill. If it went up to 7.5 percent, can you give me a really fast answer? Would we just increase that by 20 or 30 percent?

Mr. SMITH. I think you could increase that by about 2½ times. If it is roughly \$4 and something for a 1-percent increase, then it would be double that for a 2-percent, 2½ times, for 7.5 percent rate on that one loan.

Mr. COLEMAN. Therefore, it is possible that the cost to the consumer under this bill would be \$8 to \$8.75?

Mr. SMITH. It could be as much as that. We would hope that it would not exceed the \$4 or \$5 per loan on an average loan amount, because hopefully interest rates will not go any higher than 11 percent.

I do not believe that either the Congressional Budget Office or this administration is projecting interest rates to remain as high as 11 percent.

Mr. COLEMAN. Mr. Chairman, my time is up. I thank my colleague, Mr. Skeen, for yielding to me.

His last statement I think was important. He said that he did not think that the administration was forecasting higher interest rates, and so forth. I think it goes to the heart of what Mr. Skeen had asked for, which were some of the studies—GAO, even our own Congressional Budget Office. I would like to have that information, because we are throwing figures around, and I am sure everybody will be throwing figures around. We will have computer printout versus computer printout on this thing eventually. I think Mr. Skeen's suggestion that we have the CBO report, if not a couple of the other reports that are coming, is a good one in order to let us know more about these particular issues, such as interest rates and their forecasts. I do not know what CBO has, although I understand it could be completed in a couple of days. It could help everybody understand what the effect of this legislation might be.

Mr. JONES of Tennessee. Thank you, Mr. Coleman.

Mr. DASCHLE, do you have any more questions?

Mr. DASCHLE. I have no questions, Mr. Chairman.

Mr. JONES of Tennessee. I have one more question for the panel, and it makes no difference who answers it, or all of you may do so, if you would like to take the time to do it.

Administrator Hunter has made the point that he sees the current requirement for REA to pay the \$7.9 billion to the Treasury Department beginning in 1993—this is something Mr. Coleman and some of the rest of them have been talking about to some extent—as a firm commitment which should not be broken now.

As we all know, things have a way of changing over a 10-year period. I would like to know, from any of you, the bankers and all, if you would comment on what you see as some of the changed circumstances since 1973 which now warrant the conversion of the money into permanent capital in the Revolving Fund.

I would be glad to hear from anyone.

Mr. PARTRIDGE. Mr. Chairman, if I may lead off on that, I think it is clear that the program designed by the Congress in 1973 has worked, and worked well. It was impossible, of course, at the time that bill became law to know that we would have an inflation rate which would cause us to draw much more heavily on the Revolving Fund than we had ever anticipated we would need to do, with the higher cost of construction running up the amounts that had to be invested, and coupled with that the interest rates that came with the Arab oil embargo and the inflation of that period. The two combined did move in the direction, as former Administrator Feragen pointed out, to the point where we were going to run into problems eventually, and without taking some corrective action, the Revolving Fund would subsequently be out of balance.

This legislation would provide the necessary corrective action. I think it is important to convert the capital which is in that Revolving Fund into capital, rather than debt, in order to assure that it will continue to be a mechanism which can and will fund the REA insured loan program.

As I hope we have brought out in our testimony here this morning, the continuance of the REA program is vital not only because of its own input, but because the other financing, that provided by CFC, by the investment banking community, by the Banks for Cooperatives, is built on that solid foundation. The program makes a contribution in its own right, of course, in providing the capital that it does.

It will not be able to do that unless this capital is left in that Revolving Fund. There is no way that we could possibly raise the interest rates high enough or fast enough to stem the drain of the Revolving Fund unless the Fund is capitalized. That is the purpose of this legislation.

Mr. JONES of Tennessee. Thank you very much, Bob, for your comments.

Anyone else?

Mr. CLAPP. Mr. Chairman, I would like to call the committee's attention to the fact that in my tenure as Administrator of REA I think, if my recollection serves me correctly, the average loan program in the course of a year was somewhere in the neighborhood of \$350 or \$400 million. Here in 1983 we are talking about loan requirements for the distribution co-ops, a loan level out of the Revolving Fund, of \$800 million. The whole frame of reference in terms of dollars as shifted upward by that much and more, because that \$400 million that I spoke of in the sixties and the early seventies was for both distribution and generation and transmission, and the Revolving Fund is addressed primarily, if not solely, to the needs of the distribution co-ops.

Your whole frame of reference dollarwise has shifted up so high that the initial requirements that were envisioned just are not valid anymore.

Mr. JONES of Tennessee. Thank you, Mr. Clapp.

Anyone else? Mr. Feragen, do you want to say anything? Mr. Lewis.

Mr. LEWIS. Mr. Chairman, if I may, going back to what Mr. Partridge said, it was the intent obviously of Congress to set up a Re-

volving Fund that would be viable out into the future. Because of the things that he has mentioned, making it necessary to go beyond the Revolving Fund to meet the needs of the program, basically inflation and so forth, when the year 1993 comes along, when the next note is due, if things had gone according to plan, there would be sufficient funds to begin to pay back those notes. Obviously, under these circumstances, even under this bill, there will not be sufficient funds to siphon off over a period of 20, whatever years it is, the \$7.8 billion. The Fund then will be depleted, as we have pointed out, each year more so. Therefore, we will have no Fund. That is my point. The Fund will just be washed out, as we each year are required to make those repayments.

Mr. JONES of Tennessee. Thank you very much, Mr. Lewis. I see my time has expired.

This concludes the session on hearings of the bill H.R. 3050.

I want to thank all of you for having been here for the meeting the 2 days that we have met.

I see that we have gone over almost an hour, but I would like, if it meets the agreement of the members of the subcommittee, to meet again about 2:30 and give consideration to a markup at that time.

Does anybody have any objection?

Mr. COLEMAN. I do not think we are that formal to reserve the right to object, but let me ask you this: Are you talking about a markup at 2:30 or are you talking about meeting to talk about a markup?

Mr. JONES of Tennessee. A meeting to talk about a markup.

Mr. COLEMAN. When it might be performed or are we going into markup at 2:30?

Mr. JONES of Tennessee. If we can go into a markup at 2:30, it will be fine. If we can't, we can talk about it and see what we can do.

I am ready myself.

Mr. COLEMAN. I have several meetings where people expect to see me and I was not prepared to meet this afternoon.

Mr. JONES of Tennessee. It is possible we cannot because I have not talked—I know I have another set of hearings tomorrow, and you have, too, on this drought situation. It is possible we cannot do it, but we have a recess coming up until the 17th. Therefore, I hate to leave this legislation hanging here like this until then.

If you do not mind, let's meet here and try to be here at 2:30 for a meeting.

We stand in recess until 2:30.

[Whereupon, at 12:51 p.m., the subcommittee recessed, to reconvene that same day at 2:30 p.m.]

AFTERNOON SESSION

Mr. JONES of Tennessee. The Subcommittee on Conservation, Credit, and Rural Development will come to order.

The subcommittee members who are here have been discussing as to whether or not we would have a markup today or delay it until we return after October 17. The decision by a majority of those present is that, since we have such a short time this after-

noon and there are votes on the floor this afternoon, and there are some other extenuating circumstances, we will delay the markup until after October 17.

As soon as we have finished with the markup in the subcommittee, we will ask the chairman, and I have already confronted him with this, to take it up in the full committee immediately, and we will take it to the floor of the House as soon as possible. It is already on the agenda.

That will stand. The subcommittee will stand adjourned until the call of the chairman.

[Whereupon, at 2:39 p.m., the subcommittee recessed, to reconvene at the call of the Chair.]

[Submitted material follows:]

Statement of James A. Vann, Jr., President
National Rural Utilities Cooperative Finance Corporation
to the
House Agriculture Sub-Committee on Conservation,
Credit, and Rural Development
October 5, 1983
on H.R. 3050, Rural Electrification and Telephone Revolving
Fund Self-Sufficiency Act of 1983

Mr. Chairman, I am James A. Vann, Jr., General Manager, Dixie Electric Cooperative, Union Springs, Alabama. I have served as a member of the Board of Directors, National Rural Utilities Cooperative Finance Corporation (CFC), since 1978 and as President since February, 1983.

CFC is a cooperative financing organization owned by 926 members, including 806 rural electric distribution systems, 60 power supply systems, 60 state regional and national service organizations and 2 Associate members.

CFC was incorporated in April 1969 for the purpose of providing its members with a source of long-term and short-term financing to supplement their borrowings from the Rural Electrification Administration. The first long-term loans made by CFC concurrently with loans from REA were made in 1971. Prior to then, rural electric systems obtained all of their debt capital under the REA loan program.

During the 1960s, it became apparent that funds made available by the Government would no longer be sufficient to satisfy the capital requirements of the rural electric systems for expansion and improvement of their distribution generation and transmission facilities. CFC was established by the rural electric systems to meet this capital deficiency. The recommendation to create CFC was a part of the final report of the Long-Range Study Committee which was appointed in November 1967 by the National Rural Electric Cooperative Association (NRECA). That report included not only the recommendation for the establishment of CFC as a self-help supplemental financing source but also a statement of present and future objectives for the rural electric program.

Since 1971, when it began its lending operations, CFC has continued to add to the types of programs and services that it provides to its members. CFC now makes long-term, intermediate-term and short-term loans. It also has a very active and important program of guarantees of long-term and short-term tax-exempt industrial development bonds which provide financing for pollution control facilities required to be installed in generating plants owned and operated by rural electric systems. During the last several years, CFC has also been very active in assisting its members in lease financings. Among its other services CFC conducts financial management programs and seminars, consults with members on equity management programs and establishment of electric rates. CFC has also developed a commercial paper sales program enabling members to make short-term investments in CFC which assists the members in their cash management programs.

The 1973 amendments to the Rural Electrification Act provided REA borrowers access to larger levels of REA funding and with the availability of the REA loan guarantees, enabled power supply systems to undertake construction of major generating facilities to supply the power requirements of their member distribution systems. Throughout this period of increased activity on the part of rural electric distribution and power supply systems, CFC has maintained a very active role in providing short and intermediate-term financing which enabled its members to proceed with their construction programs in an efficient manner.

The 1970s were a period of growth and change for CFC as it adapted its programs and services to meet the needs of its members.

In November, 1981, the CFC Board, in recognition of the value and importance of periodically re-examining the role of this organization in the rural electric program, authorized establishment of a Committee on Objectives and Planning. The Committee was charged with the responsibility of reassessing CFC's goals and objectives with the purpose that the membership could have assurance its organization had the ability to meet their supplemental financing and financial services needs, both now and in the future. The Committee was also requested to examine CFC's structure and operations to determine whether it was providing services to its members in an efficient manner.

The Board appointed me Chairman and selected twenty-five leaders of the rural electric program representing distribution and power supply cooperatives and national and state service organizations from all areas of the country. The Committee held numerous meetings; undertook studies on future capital requirements of the distribution and power supply systems through the end of this century. They consulted with experts in the investment community about the most efficient ways and means of raising the capital required and reviewed rural electric program objectives in providing electricity in their service areas and undertaking activities and providing leadership in projects to improve the quality of life in rural areas. During 1982 the Committee worked very closely with the NRECA Committee on Financing for the Future, holding several joint meetings around the country with rural electric leaders and sharing data and information.

The CFC Committee presented its report to the CFC membership earlier this year. The members endorsed all of the recommendations and the CFC Board is now engaged in developing and approving policies and procedures to implement those recommendations.

One important recommendation made by the Committee calls for amendment of the Rural Electrification Act "to clarify the authority of the REA Administrator to provide private lenders with marketable security for loans they make to REA borrowers" Section 7 of H.R. 3050 proposes to amend Section 306 of the Rural Electrification Act to implement that recommendation. This amendment to Section 306

would resolve many of the problems that CFC has encountered in recent years in negotiating with REA to obtain adequate security for the loans that CFC makes to its members. Governor Gill will discuss the significance and importance of this provision in more detail.

CFC also endorses the other provisions of H.R. 3050 to amend the Rural Electrification Act, particularly those which will assure the continued viability of the Rural Electric and Telephone Revolving Fund. Enactment of these amendments would assure that the Revolving Fund will continue to be available to fund all loans made by the REA Administrator, including those which are made concurrently with CFC loans.

On behalf of CFC's Board of Directors and its members, we thank you for the opportunity to present our views.

STATEMENT OF NORMAN M. CLAPP
FORMER ADMINISTRATOR
OF THE RURAL ELECTRIFICATION ADMINISTRATION (1961-1969)
Before the
SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT
COMMITTEE ON AGRICULTURE
UNITED STATES HOUSE OF REPRESENTATIVES

October 5, 1983

Mr. Chairman and Members of the Committee:

I deeply appreciate the opportunity to appear before this Committee in support of H.R. 3050 "to ensure the continued financial integrity of the Rural Electrification and Telephone Revolving Fund, and for other purposes."

As one who was privileged to serve as Administrator of REA in the Administrations of President Kennedy and President Johnson and had a hand in the historic breakthroughs the REA program scored in those years, the future of both rural electrification and rural telephone service is naturally of deep and abiding concern to me.

Since leaving REA, my professional activities have enabled me to keep in touch with the progress--and the problems--of both rural electric and telephone service. In the past ten years, I was first called upon by Governor Lucey of Wisconsin to fill out the unexpired term of the chairman of the Wisconsin Public Service Commission. Following this, I joined the consulting firm of Development and Resources, Inc. as Vice-President for Energy and an associate of the late David Lillienthal, the head of that firm. In 1977, at Governor Carey's request, I conducted the State of New York's investigation of the electric power black-out in New York City.

In subsequent activities as an independent consultant I have, among other assignments, assisted the NRECA-CFC** Power Supply Study Committee in the preparation of its report, "Electric Power Supply...Issue of the 80's." As a former Administrator of REA I sat on NRECA's Committee on Financing for the Future, which considered in depth throughout last year the problems to which this legislation is addressed.

Although no longer actively engaged in the consulting business, I am currently still a member of the board of directors of Stone & Webster Power Projects Corporation, a relatively new member in the Stone & Webster family of companies long identified with the electric utility industry.

Because this background and experience has been more closely related to the problems of rural electrification than rural telephony, I limit my observations to the portions of the legislation before you today dealing with the financing of rural electric facilities and service. I hasten to add, however, that this in no way implies any lesser importance of the needs and problems facing the future of REA financed rural telephone companies and cooperatives.

I am gravely concerned about the future of rural electrification unless H.R. 3050 or legislation substantially similar to it is enacted without undue delay.

**National Rural Electric Cooperative Association and National Rural Utilities Cooperative Finance Corporation.

Events of the past ten years have placed unusually heavy burdens on the REA-financed rural electric cooperatives. Not only have the old burdens of low consumer density and limited revenue potential per unit of capital investment generally persisted, not only have inflation and higher costs of the industry generally been added to burdens of rural service too, but in addition, in this very time of higher costs and high interest rates, the rural electric cooperatives have been compelled to provide for the generation and transmission of a much greater share of their total wholesale power needs.

In 1972, the cooperatives generated 31 percent of their wholesale power needs. Generating capacity could be built for an average cost of \$200 per kilowatt. The average cost of wholesale power to the distribution cooperatives from all sources was 8 mills per kilowatt hour.

By 1982, the cooperatives were generating 42 percent of their wholesale power needs. ^{7.0 million} 15,000 kilowatts of new capacity had been added to their facilities at an average cost of \$800 per kilowatt, and the average cost of wholesale power to the distribution cooperatives had risen to 38 mills per kilowatt hour.

With the cost of wholesale power now accounting for 73 percent of the average distribution cooperative's total cost of service to its consumer members, this inevitably has a serious impact on the cost of service to the ultimate rural consumer.

Since the inception of the Rural Electrification Act in 1936, the goal of this program has been to bring electric service to rural America on terms that would, in the words of Morris Cooke, the first REA Administrator, close "the gap which now exists between urban and country life." While the emphasis and the terminology have changed from period to period depending upon the priorities of the time, this has continued to be the objective of this great effort. And I think it is fair to say that this has been the continued intent of Congress in its support of the rural electrification program needs.

To offset the obvious and demonstrable handicaps of serving the rural areas, certain equalizers were provided so that this gap might indeed be closed. The Federal government provided technical assistance and favorable financing. The rural people themselves provided the equalizer of non-profit cooperative operation.

Although understandably H.R. 3050 does not attempt to deal with all of the problems facing the rural electric systems today, it does deal with the need to preserve a source of financing on the most favorable basis realistically possible under present circumstances.

By proposing to convert the initial assets of the Revolving Fund into continuing capital of the Fund and avoid the presently scheduled depletion of the Fund beginning in 1993, it would provide urgently needed support for the Fund's future ability to meet the loan needs of the distribution cooperatives. By authorizing the Administrator of REA to make upward adjustments on interest rates on new insured loans as needed to maintain the balance between interest income and interest expense of the Fund, it would provide a mechanism to prevent the Fund from devouring itself to meet its interest costs.

These are important steps essential to the preservation of a favorable financing source for the distribution systems in their efforts to meet the service needs of their areas at costs which can once again hold forth the promise of closing the gap between rural and urban rates.

For those rural borrowers requiring special assistance to overcome extreme handicaps stemming from low consumer density, natural disaster, unusually low consumer income in the area served, or other extraordinary hardships, there is quite properly provided a special rate of interest tailored to the needs of the borrower. To the extent that this rate falls below the standard rate charged by the Fund, the Secretary of Agriculture is authorized and directed to seek reimbursement of the difference through the annual appropriation process.

These proposals are a sound and constructive blueprint for preserving the Revolving Fund for both electric and telephone borrowers as a future source of financing at a reasonable interest rate.

I am sure these sections of the Bill will be addressed in greater detail by other witnesses.

I should like to say in passing, however, that the willingness of the leadership of the REA-financed systems to accept the modest increase in interest rates which may be required under this proposal in order to balance interest receipts with the interest costs of the Fund likewise reflects the constructive and most commendable spirit with which the cooperatives have approached this problem.

What we are dealing with here is not only the continued viability of REA financing, but also the cost of that financing. The proposed package for balancing the Revolving Fund, while involving some increase over the present 5 percent rate on direct insured loans, still holds forth the promise of rates substantially below the open money market.

There is, however, an urgent need to deal with the high interest rates which have been required on the guaranteed loan program, the source of G&T financing.

These interest rates are placing the entire REA electric program and its objectives in jeopardy.

At the close of 1982, the total loan advances outstanding in the REA electric program amounted to \$32.3 billion. The total annual interest bill on these obligations is \$1.3 billion. Of that amount, \$910 million is the interest bill of G&T cooperatives. That amounts to 12 mills per kilowatt hour of power produced for interest alone. And it is going higher as new facilities come on line financed at the recent high interest rates that have plagued the economy in the past five years.

I have already alluded to the dominance of wholesale power costs in the ultimate cost of electric service to the rural consumer. Since 1973, the G&T cooperatives have been solely dependent upon the guaranteed loan program of REA. The impact of high interest rates on G&T loans under the guaranteed program is obvious. Individual G&T cooperatives are finding that their interest costs are running 30 to 40 percent of their total operating costs, rivaling and sometimes exceeding even fuel as the major cost factor in wholesale power production.

With interest rates on the guaranteed loans having been as high as 12 to 15 percent in 1981 and not much below that today, the interest burdens facing the G&T's promise to reach even greater severity unless refinancing is possible as these rates moderate in the future.

A reduction of a single percentage point in the average interest rate for the REA-financed G&Ts would mean an annual saving of \$206 million, based on the current level of advances, or 2.6 mills per kilowatt hour produced.

Something must be done to bring the interest cost in wholesale power supply down to levels consistent with the overall parity objectives of the rural electrification program. This Bill opens the door to this possibility. The refinancing authority it contains is one of its greatest virtues.

I call the Committee's attention to Section 5 and Section 7 (4) of the Bill which opens the way for the future refinancing of existing obligations in both the insured and guaranteed loan programs if and when interest rates come down to more reasonable levels. This authority would help the Administrator keep interest costs of the Revolving Fund down in the future and hence ease the need for upward adjustment of interest rates on insured loans. It would be of even greater impact, however, in permitting readjustment of interest costs on the greater debt volume incurred by the G&T cooperatives through the guaranteed loan program.

The past decade has been a difficult time for the entire electric utility industry. Escalating fuel costs flowing from the first Arab oil embargo in 1973 and 1974, intensified public requirements for the protection of the natural environment from the effects of generating and transmitting electric power, a vacillating public policy in the development of nuclear energy as it sought to respond to popular fears and protests, and the multiplying procedural requirements and delays to get all this done have had a devastating effect upon the ability of electric utilities of all kinds to plan and finance needed additions to their facilities.

It has been a particularly difficult time for the rural electric systems because they have been forced by circumstances to shoulder a much larger portion of their own power supply at this time of drastically higher costs. They have had a smaller capacity base to absorb and dilute the cost effects of these recent high-cost increments. As a result, the impact on their rates has been more severe than in the industry at large.

Add to all this the unprecedented explosion of interest rates of the last five years, and you have the rough outline of the crisis rural electrification faces today. After years of declining rates and progress toward closing the gap between rural and urban based service, the gap is now widening. And it is being felt at the grass roots level, as mounting consumer complaints and unrest attest.

The legislation before this Committee today is sorely needed to stabilize the Revolving Fund as a continuing source of financing for the distribution systems and an opening wedge for refinancing excessive capital costs of their wholesale power organizations.

The alternative, I fear, is the continued erosion of and ultimate destruction of the hope for electric service in rural areas comparable in quality and cost to that enjoyed by adjacent urban oriented service areas.

This, if it is allowed to happen, would be a national tragedy.

TESTIMONY OF ROBERT W. FERAGEN
BEFORE THE HOUSE OF REPRESENTATIVES SUBCOMMITTEE
ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT

October 5, 1983

Mr. Chairman and members of the Committee, my name is Robert Feragen. I am Manager of the Administrative Services Division at East River Electric Power Cooperative, Madison, South Dakota. During President Carter's term I appeared before this Committee as Administrator of the Rural Electrification Administration. I appreciate very much the opportunity to appear before you again to make a statement in strong support of HR 3050, the "Rural Electric and Telephone Revolving Fund Self Sufficiency Act of 1983."

I believe the basic question before Congress in considering these proposed modifications to the Rural Electrification Act is whether or not to preserve the fundamental relationship between Congress and the rural electrification program. I have observed over the twenty years I have been associated with this program that those who oppose continuation of the program -- whether because of economic theory or political philosophy -- first want to sever the program from Congressional oversight. And although there have been good years and lean years during the history of the program, the Congress -- including members from both political parties -- have consistently supported this fundamental relationship because they knew the value of rural electrification to rural America.

Soon after becoming REA Administrator in October, 1979, I became aware of the problem faced by the insured loan program based upon the

Revolving Fund. My staff and I knew that it could not long be sustained if the level of 5% loan needs were to be maintained at the levels set by Congress and at the same time had to pay 13% and 14% for Certificates of Beneficial Ownership as obligations of the Fund to the Treasury for about one-half of the loan needs. A floating rate on insured loans to REA borrowers appeared to be the most direct way to maintain loan levels and solve the problem without seeking appropriations again. We sought the counsel of program leaders and urged early attention to preserving the Revolving Fund. It was gratifying to me that the NRECA Board of Directors decided to appoint a committee to study the matter carefully and to prepare recommendations for them and the membership. I was also very pleased and honored to have been a part of the work of the NRECA Committee on Financing for the Future. That Committee's recommendations, adopted by the membership, are carefully reflected in HR 3050. I strongly urge its passage as being essential to a rural electrification program able to maintain the objectives of area coverage, non-profit operations, and basic rural areas development.

In North Dakota and South Dakota -- my native and nurturing states respectively -- many rural systems continue to provide area coverage electric service with fewer than one consumer per mile of line. Three to four consumers per mile are the most dense service areas we have. All these systems must have REA loan programs to survive because the already high interest costs paid through their wholesale rates, together with their own interest costs would become impossibly high if these systems were asked to depend solely or largely upon private sources of capital.

Over the forty eight years of the rural electrification program, men and women in rural America have built institutions run by local people and serving local needs. Rural electrification has enriched rural communities, not individuals. In itself it has been a superlative rural development program. But in addition, many local cooperatives actively work for broader rural development, such as establishment of rural water systems. People who claim that the work of rural electrification is over do not know or live in rural areas. We must preserve these objectives by preserving the program as it has been successfully conducted all these years. That means the continued involvement of Congress in decisions about REA loan levels, rural area needs, and resource development. HR 3050 assures that relationship for the foreseeable future and its successful adoption will signal to rural Americans that it is not to be abandoned to even higher electric energy costs because of higher interest costs.

There are three major points about the rural electrification program's needs today upon which I wish to comment. First, as the members of this committee are aware, rural electric consumers bear a monumental burden of interest costs in their electric bills. To claim otherwise is to ignore the structure of rural electric cooperatives and the fact that it is rural people, not the utility systems which pay the costs. In the Missouri Basin we operate rural electric cooperatives on a three tiered basis: (1) the local distribution cooperatives, and (2) generation and transmission (G & T) cooperatives which the distribution systems organized for the purpose of transmitting bulk power to these local systems, and (3) the G & Ts in their turn organized Basin Electric Power Cooperative, with headquarters in Bismarck, N.D., as a regional generating cooperative which builds and operates power

production facilities. The cooperatives at each level have a burden of interest costs which become part of their rates. Basin Electric, because it is not eligible for insured loans under loan criteria which has been in effect for ten years, must finance facilities through the use of the REA guaranteed loan program. High interest costs in excess of 10% which have persisted over the past five years are paid by the consumer at the end of the line. There is nothing complicated about that fact.

The distribution systems which purchase all their wholesale power from East River typically have wholesale power costs which represent 60% or more of their total operating costs. An unbelievable 34% of the East River power bill to its member systems is interest cost -- that reflects the amount which Basin Electric and East River add into their rates to cover the cost of borrowing money.

The major impact of interest costs is felt from those costs associated with the large investments required for generating plants. Basin Electric's interest costs as a percentage of its wholesale power rate have increased dramatically over the years, as can be seen in the following:

1966	11.5%
1970	9.9%
1975	5.4%
1980	17.6%
1981	30.4%
1982	35.7%

No one should diminish the importance of this fact. It is experienced by every rural electric system in the country, whether the

interest cost is coming from an REA borrower, G & T supplier, or from a private utility. The high interest costs are in the rates which the consumers pay. Therefore, it is not correct to say that because the distribution systems are eligible for 5% loans at the present time that the rural electric systems are getting by cheaply on the cost of money. The big investments, and the biggest impacts on rates are the market level rates being paid by the power suppliers and included in wholesale power costs.

Therefore, I must conclude that to relieve this burden Congress should pursue every means open to it to reduce interest costs in this country. Congress can also alleviate part of the problem which the G & Ts confront with the present REA loan guarantees that are funded by the Federal Finance Bank. To date the cooperatives have had to make long term commitments to loans at high interest rates. Congress could ease this burden by making certain that the provisions for refinancing guaranteed loans are retained in HR 3050. A mandate of this kind by Congress, formalized in legislation, will have the greatest stabilizing effect upon the interest cost burdens of rural electric systems of any other single aspect of the proposed legislation.

Having stressed the importance of the refinancing provision, I also believe the proposals in HR 3050 dealing with Revolving Fund problems are of very great significance. First, this act will mean that Congress will continue to maintain its relationship with the program as I discussed earlier; and second, it will make the Revolving Fund a permanent and vital tool for financing rural electrification without resorting to appropriations.

I understand that opponents of this legislation argue that the Fund is being bailed out of an obligation to Treasury -- the repayment obligation being a provision Congress included in the 1973 amendments. This Congress can determine, as I urge it to do, that the government has decided to retain for itself the Revolving Fund in the Rural Electrification Administration. It is no bail out. The U.S. government continues to own and control the assets of the Revolving Fund. Congress should decide that this is an appropriate decision in 1983 because the purposes the Fund serves in rural America are far too important to the country to change.

Newspaper articles encouraged by opponents make it seem that the rural electric systems are defaulting on loans when in fact the rural electric systems have a perfect record of repayment of their loans. Congress should make it clear by this bill that it recognizes that good record and wants to continue its interest in rural electrification by making a permanent capitalization of these assets of the Revolving Fund.

Finally I bring an appeal to the Committee from those areas and electric systems confronting conditions much like the earliest and most difficult days of rural electrification -- areas of low population density, areas economically depressed, and those parts of the country frequently hit by devastating storms which level the rural electric systems. Availability of a special interest rate was recognized by the Study Committee and the membership of NRECA as vital to the program. The present draft of HR 3050 leaves special interest loans entirely to the discretion of the Administrator. Congress

should mandate that special interest loans be made when systems meet the criteria set by it in the legislation.

Congress has recognized the need in the past for special interest rate loans and has dealt fairly with those systems requiring them. I don't believe that systems needing special loans ought to have to lobby their congressman every time an emergency arises in order to encourage the Administrator to make a special interest loan. The same should apply when a system is serving less than two consumers per mile and require loan funds to maintain reasonable costs in their operations. We are not talking about the needs of all systems. We are talking about special needs. The cooperatives in my part of the country -- South Dakota, North Dakota, Nebraska, Montana -- and also those in Alaska, New Mexico, and Texas have all passed resolutions requesting Congress to mandate a special interest program in this legislation because it is still needed. We believe Congress should mandate that at least some of the resources of the newly capitalized Revolving Fund be used each year to serve the special loan needs of these systems. I urge this Committee to modify the proposed language of HR 3050 to make a special interest loan program mandatory under criteria determined by Congress.

Mr. Chairman, thank you again for this opportunity to appear before you. I am grateful for being associated with REA and the rural electrification program and I and other rural people are grateful to this Committee and Congress for your continued support of the REA program.

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TESTIMONY BY
THE HONORABLE RICHARD DURBIN

MR. CHAIRMAN, THE PROPOSED AMENDMENTS TO THE RURAL ELECTRIFICATION ACTS ARE NEEDED TO ALLOW THE CONTINUED OPERATION OF THE REA FINANCING PROGRAMS. IT IS TRUE THAT THE AMENDMENTS WILL INCREASE THE FINANCING COSTS FOR THE PROGRAMS, BUT I THINK THAT THE BIPARTISAN SUPPORT FOR THESE PROVISIONS INDICATES THAT WE HAVE A WELL-BALANCED, WELL-CONSTRUCTED BILL.

I COSPONSORED H.R. 3050 BECAUSE I THINK THAT THE PROBLEMS FACING TODAY'S FARMERS AND RURAL AMERICANS HAVE CHANGED SINCE THE REVOLVING FUND WAS FIRST ESTABLISHED IN 1973. AT THAT TIME, CONGRESS RECOGNIZED THAT THERE WAS A NEED TO ASSURE LONG-TERM, RELIABLE AND AFFORDABLE SERVICES TO RURAL AREAS. IT WAS OBVIOUS THAT THE COOPERATIVES DIDN'T WANT THE GUARANTEED LOANS TO MAKE A PROFIT FOR THEIR MEMBERS -- THEY NEEDED THE ELECTRICITY AND TELEPHONE SERVICE TO RUN THEIR FARMS AND TO KEEP IN TOUCH WITH THE OUTSIDE WORLD. AND, SINCE THEY LIVED AND WORKED IN SPARSELY-POPULATED AREAS, THEY KNEW THAT THE ONLY WAY TO BE SURE OF CONTINUOUS, DEPENDABLE SERVICE, WAS TO BAND TOGETHER AND JOINTLY OWN THE ELECTRIC AND TELEPHONE SYSTEMS.

IN 1973, CONGRESS RECOGNIZED THE NEED TO UPGRADE THE REA FINANCING PROGRAMS TO MEET THE NEEDS OF THESE RURAL COOPERATIVES. NOW, AFTER SEVERAL YEARS OF RISING INTEREST RATES AND INCREASING FUEL COSTS, IT IS TIME TO REEVALUATE THE PROGRAM ONCE AGAIN.

BECAUSE OF THE DEPRESSION IN THE AGRICULTURAL ECONOMY AND, ALSO, DUE TO HIGHER INTEREST RATES, THE DEMAND FOR REA FINANCING HAS BEEN GREAT. IN ORDER TO OFFER A 5 PERCENT INTEREST RATE TO ITS BORROWERS, THE REA HAD TO BORROW AT RATES WHICH EXCEEDED 10 PERCENT.

Now, the solvency of the financing system is threatened. H.R. 3050 addresses this problem by allowing the REA Administrator to set interest rates on new loans at levels above 5 percent. This will make it possible for the REA to cover the cost of interest on the capital it borrowed. Although the costs for the REA borrowers will increase, the majority of the 25 million cooperative members across the country are willing to bear the additional costs. They know that this measure will help assure the future dependability of the financing system.

This legislation also calls for a conversion of funds appropriated for REA lending prior to 1973 into a permanent fund. This money will be a stable source of capital for the financing program. Moreover, the creation of this permanent fund will not require any outlays by the Federal Treasury.

I would like to point out that this bill does not throw taxpayers' money at a problem. Actually, if enacted, quite the reverse would occur: cooperative members seeking REA financing would probably have to pay higher interest rates than before.

We must remember the setting of which we are referring when we speak of the rural electrification and telephone systems. It is the stuff of a Wyeth painting, or a western landscape; farm country as well as the quiet recreational spots that so many of us love for vacations. All of these locations need to be connected to a central service system. But, it isn't easy to build lines across fields, in rough terrain, or in the mountains. And, it isn't easy to maintain those lines and poles.

BUT, FOR THE PEOPLE WHO DAY-IN AND DAY-OUT DEPEND ON THE ELECTRICITY AND TELEPHONE SERVICES PROVIDED BY THESE SYSTEMS, IT IS ABSOLUTELY IMPERATIVE THAT THESE STRUCTURES BE MAINTAINED. IF WE WANT FARMERS TO CONTINUE TO PRODUCE OUR FOOD AT REASONABLE PRICES, WE HAVE TO GUARANTEE THE CONTINUATION OF DEPENDABLE REA FINANCING PROGRAMS.

H.R. 3050 IS A WIDELY SUPPORTED INITIATIVE WHICH WILL ALLOW THE REA FINANCING TO CONTINUE. I HOPE THAT THE SUBCOMMITTEE CAN PROMPTLY TAKE ACTION TO REPORT THIS BILL.

THANK YOU.

Statement of Charles B. Gill, Governor
National Rural Utilities Cooperative Finance Corporation
to the
House Agriculture Sub-Committee on Conservation,
Credit and Rural Development
October 5, 1983
on H.R. 3050, Rural Electrification and Telephone Revolving
Fund Self-Sufficiency Act of 1983

Mr. Chairman, and members of the Committee, my name is Charles B. Gill. I am the Chief Executive Officer of the National Rural Utilities Cooperative Finance Corporation, which is generally referred to as CFC. I appreciate the opportunity to discuss the amendments to the Rural Electrification Act proposed in H.R. 3050.

As President Vann has stated, CFC was incorporated in 1969 by the rural electric cooperatives to provide financing which would be supplemental to loans from the Rural Electrification Administration.

The need for an additional source of financing for the rural electric systems, other than REA, became quite clear during the latter part of the 1960s. After several studies, which were initiated by the rural electric systems, it was the consensus that the most efficient and economical means of securing the needed additional capital would be the creation of a self-help supplemental financing organization owned and controlled by the rural electric systems. With the establishment of CFC, the REA Administrator adopted a new policy which required applicants for loans to obtain a portion of their capital requirements "from a financial institution other than REA." He also promulgated criteria for determining eligibility for such concurrent loans and provided for their periodic review and adjustment.

Our first long-term loans were made concurrently with REA loans in February 1971. Since that time, CFC has approved over 3,700 long-term loans to distribution and power supply systems concurrently with REA loans. We have also made more than 100 long-term 100% loans to CFC members. As of August 31, 1983, approximately \$1.8-billion in long-term CFC loans were outstanding and \$584-million in long-term commitments were unadvanced.

In the last three years, CFC has approved, on average, about 250 long-term loans concurrently with REA loans. The majority of CFC's loans are for 30% of the capital required and have totaled approximately \$250- to 300-million each year.

The availability of long-term financing continues to be of vital importance to the rural electric program. Under present criteria, REA is providing approximately 72% of all of the long-term loans made annually to distribution systems. The REA loans are funded from the Rural Electric and Telephone Revolving Fund and the amendments proposed in H.R. 3050 to authorize the REA Administrator to adjust interest rates on new loans should assure that the fund will continue to function as a viable financing source for REA loans. CFC interest rates are reviewed at each meeting of the Board of Directors and adjusted to reflect cost of

long-term CFC funds. Our long-term interest rates have been as low as 7% and were as high as 14%. They currently are 11½%.

CFC obtains funds to make advances on its loan commitments from several sources. These include proceeds from the sale of collateral trust bonds, the Capital Term Certificate "equity" investments made by CFC members, and patronage capital.

To date, CFC has marketed approximately \$1-billion of collateral trust bonds in 13 bond issues which have maturities ranging from 7 to 35 years at interest rates from 7.4% to 14-7/8%. In the 11 years that CFC has been selling bonds in the market, they have received increasing acceptance by the investment community and are presently rated by major rating agencies as AA (Standard & Poor's) and AA3 (Moody's).

In addition to long-term loans, CFC provides short-term and intermediate-term loans. These programs play a most important role in enabling our members to make the most efficient use of their financial resources, while carrying out their utility responsibilities within their service areas.

Short-term loans (lines of credit) provide members with commitments for periods of up to twelve months. Through this program, CFC members are assured of a readily available source of funds to meet current cash flow needs. Currently, CFC has about \$600-million outstanding in short-term loans.

Intermediate-term loans are made for periods of up to five years. These loans are utilized primarily by power supply systems for "front-end" financing required in the planning, design and early construction phases of bulk power supply projects until such time as long-term funding becomes available. The proceeds of intermediate-term loans are used to finance such requirements as engineering, environmental and feasibility studies, site acquisitions, fuel procurement, progress payments on equipment purchases, initial funding of construction, and funding requirements of power supply systems for joint participation with investor-owned utilities in bulk power supply projects. CFC has approximately \$150-million outstanding in intermediate-term loans. In the recent past, the amount outstanding of such intermediate-term loans has been as high as \$450-million.

In addition to its direct loan programs, CFC also provides for guarantees of long-term and short-term tax-exempt industrial development revenue bonds which are sold to finance the construction or acquisition of pollution control facilities installed in a member's power generating plant or to finance the acquisition of headquarters or service buildings. The credit support added by the CFC guarantee makes the tax-exempt funds available at the lowest possible interest cost. The major rating bureaus have recently upgraded the ratings on CFC guaranteed bonds and they presently are rated A1 by Moody's and AA- by Standard & Poor's. CFC has provided such guarantees for about \$1.3-billion of long-term and interim-term bonds and tax-exempt commercial paper notes.

More recently, CFC has also provided approximately \$600-million in credit support to enable its members to participate in lease transactions.

From 1973 to 1982, loan commitments have been made to rural electric power supply and distribution systems totaling about \$42.6-billion. Of this amount, nearly \$3.1-billion have been supplied by non-governmental lenders.

Nearly all of the loan commitments from the private lenders have been made concurrently with the loan and guarantee commitments from REA. In this regard, REA has been following the statement of Congressional policy contained in the 1973 amendments to the RE Act, which said "...rural electric and telephone systems should be encouraged and assisted to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organization and other sources at reasonable rates and terms consistent with the loan applicant's ability to pay and achievement of the Act's objectives."

From the beginning of the supplemental loan program in 1971, CFC loans to its members were secured *pari passu* with the REA loans. CFC has a shared first mortgage position in proportion to the amount of its loan to the total borrowing of its member.

Section 306 of the 1973 RE Act amendments authorized the REA Administrator to guarantee loans and to accommodate or subordinate the liens of mortgages held by the REA Administrator. In its report (H.R. 93-91, page 10), this Committee stated:

"The Administrator is also expressly empowered to accommodate and subordinate mortgages in the fund, whether the mortgages are held by the government as owner or as trustee or custodian for investors who have purchased the notes secured by such mortgages. While established legal principles support the Administrator's existing power to waive or modify the government's security rights, explicit statutory authority in the bill to accommodate and subordinate government mortgages is intended to emphasize the discretionary authority of the Administrator to so accommodate and subordinate where it would effectuate the purposes of the legislation.

"These authorities to guarantee, accommodate and subordinate are expected to be exercised by the Administrator for the purpose of facilitating and supporting the ability of systems to borrow from non-REA lenders at reasonable and competitive rates and terms where their borrowing needs are beyond the resources made available for REA loans under the bill."

CFC members, particularly power supply systems, found it necessary to borrow substantial amounts of money to carry on engineering, environmental and economic studies in order to proceed with plans for building generating facilities. In many instances they were required to make substantial investments to assure adequate fuel supply and acceptable sites for the generating stations. Under REA policy and procedures, long-term funding is not available until the Administrator, among other things, makes a finding as to the feasibility and necessity of a power project. Therefore, the systems found it necessary to borrow large amounts of money, prior to receiving final REA loan approval, for as long as two to three years. To obtain the funds for these developmental activities, the power supply systems turned to CFC for "front-end" financing. CFC made these intermediate-term loans subject to REA's approval of a lien accommodation to provide CFC security. In May, 1976, REA prepared Notes on Front-end Financing of Power Supply Facilities to be used by the REA staff in processing recommendations for the Administrator's consideration and action in connection with requests from CFC for lien accommodations to secure its loans.

The guidelines contained in the REA "Notes require a finding be made that the system borrowing funds from a private lender will have adequate security to cover its obligations in the event the project is aborted. In analyzing the financial condition of a borrower, REA does not focus on the economic feasibility of the system's continued operation, but does place great weight on whether sufficient assets would be available for REA to obtain full payment of its outstanding debt if foreclosure should be necessary. REA staff have been instructed to measure the net worth ("nuts and bolts" figure) by calculating the present value of the physical assets through application of the Handy Whitman index to determine the current depreciated replacement value of the physical assets.

REA has stated that, in the absence of precedents to indicate the value of revenue flows assured by the 40 year all-requirements power contracts that distribution systems have with their power supply system the more tangible elements of security should be calculated and totaled before undertaking a determination of the value to be ascribed to member contracts.

It should be noted that the granting of lien accommodations permits a lender to have the benefit of mortgage security for its loan. This includes not only a security interest in the physical assets of the borrower but also is applicable to any additional property acquired by the system and rights to the revenue flows arising from the operations of the system. In negotiations with REA concerning specific requests for lien accommodation to provide security for CFC loans we have found that REA has consistently adopted a rigid position focusing exclusively on the need to make findings that adequate physical security" is available and that there is a "compensating benefit" for the government.

As a result of this restricted interpretation with regard to granting of lien accommodations, CFC's ability to implement programs which would reduce costs to its members has been blocked. The requirement that each transaction demonstrate that granting a lien accommodation would result in a "compensating benefit" to the government has prevented rural electric systems, with the assistance of CFC, from putting into effect business arrangements which would result in a reduction of costs of operation. This in turn would have benefited the rural electric consumer in the form of lower power rates. An example of one such instance involved a power supply system which was operating a strip mine to provide coal for its power plant. The system is required by law to meet state land reclamation standards. To assure that the power supply system carries out these responsibilities, the state agency requires posting of a bond in an amount which would be sufficient to reclaim the land in accordance with state standards. CFC developed a guarantee program which would have been at a minimal cost to the system to provide the assurance to the state that the power supply system would have access to the funds. The CFC program was structured to provide that as a condition of such a guarantee, it would receive a lien accommodation on the property of the system to take effect only if CFC were called upon to provide financing under the guarantee. REA refused to approve this guarantee arrangement and the granting of lien accommodations. As a result, the power supply system has been required to pay large annual fees to bonding companies to meet the requirements of the state reclamation agencies.

In our judgment, the efforts of the rural electric systems to follow the Congressional policy of encouraging borrowing from non-REA lenders at reasonable, competitive rates and terms is being frustrated.

The rural electric systems began their operations completely dependent upon securing all of their financing through the REA loan program. Accordingly, under the terms of the mortgage with the Government, all of the assets that they own or which they might acquire in the future are pledged to the Federal Government. The most feasible way of introducing non-Government capital into this program is through the liberal use of lien accommodations and the establishment of reasonable guidelines for granting such lien accommodations. We strongly believe that it would be most advantageous for both the rural electric systems and the Federal Government if the Administrator would conduct the REA programs consistent with the 1973 statement of Congressional policy.

The provisions of H.R. 3050 which would amend Section 306 of the RE Act would make it clear that the REA Administrator can grant a lien accommodation on a finding of economic feasibility of the operation of a borrower's system. This could be assurance that the system would receive adequate revenue through the sale of power and the borrower has, or will have, the ability to repay all indebtedness on the system. To reinforce this provision, we urge the Committee to include in its report on this legislation a specific directive that it would expect the REA Administrator and staff to carry out

the intent of this amendment so that other lenders will be able to provide financing at reasonable rates and terms.

We believe that the directive which the Congress urged the Administrator to follow, as described in the statement of legislative intent in the 1973 amendments to the Rural Electrification Act, has not been carried out. Therefore, we believe it is necessary for this directive to be expressed in legislation, which is the purpose of the amendment to Section 306 of the Rural Electrification Act contained in H.R. 3050. The thrust of this amendment is consistent with the rationale which has been followed for many years to support debt financing for municipal utilities. Bonds issued by municipal utilities are supported entirely by the revenues produced from their operations. The investment community has recognized that economic feasibility is a valid test in determining the quality of the bonds and rate them accordingly. We believe the directive proposed in this amendment would insure the creation of a sound public and private partnership for the rural electrification program.

STATEMENT OF ROBERT R. EDMISTON
PRINCIPAL, LEHMAN BROTHERS KUHN LOEB INCORPORATED
INVESTMENT BANKERS, NEW YORK

Before the House Committee on Agriculture; Subcommittee
on Conservation, Credit and Rural Development

October 5, 1983

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to discuss various aspects of private market financing for rural electric cooperatives. My firm, Lehman Brothers Kuhn Loeb Incorporated, has been closely identified with the financing of rural electric cooperatives for almost two decades. It has served as principal investment banker for National Rural Utilities Cooperative Finance Corporation ("CFC") since its founding fourteen years ago. My primary responsibility for the past seven years has been the providing of various investment banking services to rural electric cooperatives principally through CFC.

Development of Private Market Financing for Rural Electric
Cooperatives

The rural electrification program is about to enter its sixth decade having undertaken to render a continuing public service, essential to the health, safety and livelihood of their rural member consumers. It is a proud record of achievement. Government support has been used intelligently and with integrity to build a sound industry of over 1,000 electric utility systems. Also, these utility systems have not been satisfied to rely solely on government financing; beginning fifteen years ago, they instituted a "self-help" effort which resulted in the formation of National Rural Utilities Cooperative Finance Corporation ("CFC") as an independently financed, membership-owned institution to supplement the federal financing program. This unique financial intermediary has been the principal means by which rural electric cooperatives have accessed the private capital markets. CFC now has in place loans, commitments and guarantees of approximately \$7.1 billion.

CFC, created in 1969, was an untried and untested financial institution that had one overriding objective: to provide its members with reliable and cost effective access to private

capital markets in order to supplement the Rural Electrification Administration ("REA") program. Fundamental to the achievement of this objective was the realization that the rural electric systems could obtain capital at a lower cost by working together than they could by marketing their credits individually.

Prior to the formation of CFC, non-REA financing was rather modest. As far back as 1968, the 28 distribution cooperatives in Ohio combined in Buckeye Power, Inc. to finance a 615mw coal fired unit. The unit cost \$72,000,000 and the sale of \$62,000,000 of first mortgage debt to a group of insurance companies was the first time the rural electric cooperatives had entered the private capital market. The cooperatives at that time were a complete unknown to investors. In the case of Buckeye, investors were able to place primary reliance for the credit-worthiness of the project on the fact that Ohio Power Company, then an AA rated subsidiary of American Electric Power Co., was committed on a take or pay basis for all the output of the plant not utilized by the member cooperatives.

In the early 1970's the REA, CFC and private investors jointly financed the \$125,000,000 Charleston Bottoms project in Kentucky. Outside first mortgage financing was obtained principally from insurance companies for 60% of project cost.

CFC has, since the inception of its loan program in 1973, provided over \$1.8 billion of long-term loans to REA borrowers, and has constituted by far the major source of private funds to supplement REA-insured loans to distribution cooperatives.

The major source of financing for power supply cooperatives has been through the funding of REA guarantees by the Federal Financing Bank. Private-market financing by power supply cooperatives to date exceeds in gross amount that of distribution systems, and has been much more diversified in source of funding, with greater reliance on direct issuance. Whereas all but a negligible amount of supplemental financing for distribution systems was secured from CFC, significant sources of supplemental funds for power supply cooperatives have been the tax-exempt pollution control revenue bond market, lease transactions, the Banks for Cooperatives and commercial banks.

While CFC has not had as primary a role in power supply supplemental financing as it has for its distribution members.

its participation has been significant. CFC has provided to date approximately \$150 million in direct long-term loans to power supply systems, and it has provided a total of \$3.6 billion in intermediate loans, principally to finance front-end expenditures for power plant construction. In addition CFC has provided its guarantee for approximately \$1.2 billion of tax-exempt pollution control revenue bond financing.

Several cooperatives have entered the tax-exempt market on their own credit while others have used credit support, generally a commercial bank letter of credit. Directly-issued obligations of this type total about \$1.2 billion.

In the past several years power supply cooperatives increasingly have taken advantage of leasing, in various forms, to supplement conventional borrowing as a means of financing the acquisition of capital assets.

Another source of private market borrowing for rural electric cooperatives has been the Bank for Cooperatives. At year end 1982 the Bank for Cooperatives had approximately \$1.1 billion committed to rural electric cooperatives. Most of its loans have been made to power supply cooperatives for the purpose of funding REA guarantee commitments. They have also provided some short-term funding and lease guarantees for eligible power supply cooperatives, and a small amount of short and long-term loans have been made to distribution cooperatives.

Rural electric cooperatives have steadily enlarged their participation in the private capital markets in recent years. Their securities are gaining increased market acceptance. However, the percentage of long-term debt obtained outside the REA has not changed much in recent years as the REA annually continues to supply about 90% of long-term debt requirement for the rural electric cooperatives. While the percentage has changed very little, there has been a tremendous expansion of investment in power supply facilities by the cooperatives in all regions of the country to keep up with demand. From 1973, when the REA act was amended to authorize loan guarantees, through 1982, REA had guaranteed about \$30 billion for power supply financing requirements. Thus while the increase in private market financing for cooperatives has been significant, its share of total long-term financing has been fairly constant in recent years because of the rapid growth of capital required.

Market Acceptance of CFC

We have witnessed a steady improvement in the quality of CFC, its credit rating and investor acceptance of its obligations. Its initial entry into the capital markets was in 1973

when it raised supplemental funds for distribution cooperatives by offering \$50 million of its collateral trust bonds. At the outset, because it was a new and unique concept, untried in the market, its collateral trust bonds were given an A rating. Although this is an investment grade rating (the four investment grade categories are AAA, AA, A and BBB) and the level of most of the investor-owned utilities at that time, CFC aspired to better. In 1975 one agency upgraded CFC to AA and in 1979 it became rated AA by both of the major credit rating agencies.

To date CFC has raised \$1 billion in the taxable or corporate bond market. These obligations are purchased primarily by pension funds, mutual funds and insurance companies, and enjoy widespread market acceptance. There are active secondary markets in many of the individual issues CFC has offered. These obligations have on balance traded as a strong AA credit.

CFC's credit rests on the quality of its member borrowers and the risks associated with any financial intermediary. The recent decline in distribution cooperatives and CFC's interest coverage ratio has produced some pressure on the relative valuation of its debt by the market. Although these trends appear to have been arrested a resumption of these trends would impair CFC's ability to provide capital to its members at favorable rates.

CFC has also been active in two other markets - the tax-exempt market and the taxable commercial paper market.

CFC's guarantee program for tax-exempt pollution control revenue bonds issued in connection with power projects totals \$1.2 billion. Such guarantees provide valuable support in attracting private (non-CFC) funding. Of the \$1.2 billion CFC-guaranteed pollution bonds outstanding, approximately \$300 million is for long-term bonds and \$900 million is for short-term. During the recent period of historically high interest rates, their program has offered short term tax-exempt funding flexibility either through bank loans arranged by CFC, Bond Anticipation Notes of up to three years or tax-exempt commercial paper. These obligations have been widely marketed to individuals, money market funds, bank trust departments, insurance companies and bond funds.

CFC's tax-exempt obligations are presently rated A1 by Moody's Investors Service and AA- by Standard & Poor's Corporation having recently been upgraded from A2 and A+ respectively.

CFC issues commercial paper -- or unsecured promissory notes issued primarily by corporations for the purpose of raising short-term funds - to provide funds for short - and intermediate-term and variable rate long-term loans to members. CFC has been very successful in attracting a large volume of funds from this market. Outstandings at May 31, 1983 totaled \$880 million and have been as high as \$1.3 billion. Primary investors include CFC members, corporations, bank trust departments and state and local governments. CFC's commercial paper carries the highest ratings awarded by the rating agencies and trades at the most attractive rates available to any issuer in this market.

The credit ratings and market acceptance attained by CFC signifies many things. It shows that CFC was soundly conceived by its founders and that its organization and purpose has stood the test of time. It has demonstrated that it is being prudently and responsibly operated and managed. Finally it shows confidence in the sustained quality of CFC's member-borrowers and the excellent credit record of rural electric cooperatives since their inception. In the final analysis the fundamental credit and acceptance by the marketplace depends upon the quality of its loan portfolio.

Real progress has been made in educating investors to understand not only the consumer-owned cooperative philosophy but also many of the unique characteristics of rural electric cooperatives. It is, however, a continuing process to maintain and enlarge market acceptance.

Financial Conditions of Rural Electric Systems

In the past 10 years the operating environment for the electric utility industry has undergone dramatic change. Prior to this period the industry was relatively stable with the growth in demand for electricity highly predictable.

All of that changed with the inflation and enormous increase in fuel costs that took place in the 1970's. This in turn increased capital costs for new generating plant. We discovered the surprising price elasticity of electrical energy demand and cut back on consumption. Consumers pressured managements and regulators to minimize rate increases and consequently the financial position of all utilities eroded.

The events of recent years create a more than normal uncertainty to the outlook. Not only have the business risks increased but so too have the financial risks. Utilities have less to offer investors in an increasingly competitive, volatile and changing capital market.

Important measures of any enterprise's financial strength are its coverage ratios. These ratios relate the financial charges incurred by a company to its ability to meet these charges. The more important ratios, used extensively in the rural electric cooperative program, are the times interest earned ratio (TIER) and the debt service coverage ratio (DSC). TIER is the ratio of net margins plus interest in a reporting period to the interest charges for the period. The higher the ratio the stronger the financial condition.

In 1982 the TIER ratio for the 802 CFC member distribution borrowers was 2.16 times. This may be contrasted to interest coverage ratios of approximately 2.9 times for the larger investor-owned segment of the electric utility industry. Rural electric distribution cooperatives as a condition of their mortgages with the REA are required to design rates that will result in a TIER of at least 1.50x. In addition, maintenance of these minimum ratios is a requirement of the CFC loan agreement. Minimums in investor-owned utility mortgages are 2.0 times and must be achieved prior to issuance of additional debt. Interest coverage ratios of CFC member distribution cooperatives have declined steadily the past ten years from a level of about 3.6 times in 1972 to 2.16 times in 1982. The same has been true of the investor-owned utilities which in the late 1960's and early 1970's attained coverage of 3.5 to 4.0 times. As a result there has been a continuous decline in credit ratings of investor-owned utilities from an average of AA to a weak A to strong BBB level today.

Recent efforts to improve the financial position of rural electric distribution cooperatives have met with some success. However, current coverage ratios of the distribution cooperatives are barely adequate to assure the availability of supplemental capital at reasonable cost.

Another measure of financial strength - the ratio of equity to total assets - has also declined. In 1972 CFC member distribution cooperatives equity as a percentage of total assets was 34%, in 1982 it was 28%.

These measures of financial strength have an important impact on the ability of cooperatives to attract capital and the cost of that capital. Other important factors bearing on the cost and availability of private market capital for rural electric cooperatives are:

- The magnitude of REA capital availability and the supervisory role deriving from conditions of the REA mortgage

- Prospective capital requirements and construction programs
- Regulatory and legislative environments
- Underlying economic base of the service areas
- The strength of the power supply contract between the power supply cooperative and its distribution members

In assessing the credit position of rural electric cooperatives and comparing their position to that of enterprises that obtain all their capital from the private market, special emphasis must be placed on the degree of REA involvement, the amount of power supplied from their own generation capacity (40% for rural electric cooperatives versus 100% for investor-owned utilities) and the prospective level of capital requirements. Omnipresent in any consideration of the financial condition of rural electric cooperatives is their especially difficult and costly task of supplying electricity to the less densely populated areas of the country. This is exacerbated by the fact that demand for electricity in rural America has generally been growing at twice the rate for the rest of the country. This trend is forecast to continue in the future.

The credit quality of the entire utility industry has declined in recent years and, on balance, the rural electric component due to its special characteristics is judged from a credit perspective to be weaker than the credit of the investor-owned utility industry. As supplemental financing increases the financial standards of rural electric cooperatives may require modest improvement to assure access to capital on reasonable terms.

Importance of REA Financing to Assure Adequate Power for Rural Electric Cooperatives

Basic to the assurance of a reliable supply of power is the availability of capital to finance needed plant additions. The securities market in recent years has become highly volatile with competition for funds -- especially long-term funds -- intensifying. Rapid and unexpected changes in interest rates, and changes in investor objectives have been revolutionizing our securities markets.

A source of continuing concern is over the depth of the market for long-term debt maturities which the financing of utility plants

requires. The REA guarantee funded through the Federal Financing Bank offers loans of 35 years duration. This is the same term which the REA program has provided since the 1944 amendments to the Rural Electrification Act. The entire financial structure of the industry is based upon a rate of amortization over 35 years which coincides with the estimated useful life of the facilities. Sound utility financing is premised on financing long lived assets with long term funds.

For power supply borrowers, access to the REA guarantees with funding through the Federal Financing Bank has provided favorable borrowing costs. However, the greatest benefit which REA has consistently provided to rural electric systems is guaranteed availability of long term capital.

Given the nature and magnitude of power supply requirements (\$30 billion of guarantees provided since 1973) we believe that without the REA guarantee program this volume of funds could not have been raised from the private market in the amounts and maturities required.

Our Firm recently completed a study (Report to Committee on Objectives and Planning of National Rural Utilities Cooperative Finance Corporation) which analyzed the expected capital needs of rural electric cooperatives and their ability to meet these requirements in the private capital market under various levels of government support. A summary of the conclusions of this report is appended.

The Report examined the expected capital needs of power supply cooperatives over the next few years against assumed future levels of REA support. We concluded that if REA guarantee availability is not sufficient that the private market could accommodate a portion but not all of the anticipated capital needs. Meaningful access to the private capital markets will have to be developed over a period of years and in the context of a strong continuing commitment during a monitored transition.

It is important to note that if the development of supplemental financing for power supply cooperatives proceeds in an orderly manner, private market capital can be attracted without a substantial and costly enhancement of rural electric financial standards. As noted in the Appendix, the means exists for power supply systems to use a collective financing vehicle, similar to CFC, to achieve the greatest efficiency of access to the capital markets at the lowest cost through the pooling of individual power supply credits.

As rural electric cooperatives continue their efforts to enlarge their participation in the private markets, it is essential to offer investors adequate security for their loans. The government must be willing to equitably share its all encompassing security interest with private lenders. The proposed amendment to Section 306 of the Rural Electrification Act, particularly with respect to the accommodation of liens of non-REA lenders, will facilitate and further the development of non-REA credit for rural electric cooperatives.

Subordination will clearly enhance the creditworthiness of cooperatives. However, as in the case of lien accommodations fairness also dictates that the position of the government not be unduly weakened by subordination. Subordination of the security interest of the government in any loan should be carefully considered and evaluated in a judicious manner.

From the perspective of the private market lender, subordination is a marked improvement in the security position of a prospective senior lender but does not diminish the necessity of the borrower to demonstrate the ability to meet debt service payments. The foremost consideration in credit evaluation is the consistent capacity to meet fixed payment obligations over a long period of time. While some will argue that subordinated debt is debt that serves as "equity" it is nonetheless debt accorded all the customary rights and protections of a debt instrument.

Subordination enlarges private market capital access for rural electric cooperatives but it will have to be accompanied by a modest improvement in financial standards in order to meaningfully increase the proportion of capital obtained from this market.

REPORT TO
COMMITTEE ON OBJECTIVES AND PLANNING
OF
NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
FINDINGS AND RANKING OF FINANCING ALTERNATIVES

The Committee on Objectives and Planning ("The Committee") of National Rural Utilities Cooperative Finance Corporation ("CFC") has undertaken a major study of the future capital requirements of the rural electrification program and the possible means by which these requirements can be met, with particular emphasis on financing alternatives to the Rural Electrification Administration's ("REA") present lending programs.

As our contribution to this study, Lehman Brothers Kuhn Loeb Incorporated ("LBKL") has prepared this Report, which analyzes the anticipated financial requirements of the distribution cooperatives and the power supply generation and transmission cooperatives ("G&Ts"), places these requirements in the context of the general money markets and the competitive demands for investment funds, and reaches conclusions as to the relative merits of different private financing alternatives under varying market conditions and levels of government support. The Report also analyzes CFC's role in financing its member systems, recommends certain changes in CFC's structure, and describes a new method for the collective financing of the G&Ts with CFC support which we believe to have substantial merit. In carrying out this assignment, our overriding goal has been to balance the twin objectives of maximizing total capital availability and minimizing financing costs to the ultimate consumer.

This Report has drawn on LBKL's broad expertise as a major investment banking firm and more particularly on our knowledge of the rural electric program gained from our close association with the original Long Range Study Committee and with CFC since its formation.

In judging CFC's capabilities in the years to come, we deal with projections and prognostications. Sharing the human inability to see into the cloudy future, it has been necessary to form certain judgments about trends and markets, as well as levels of government support, interest rate levels, demand for funds and many other factors in order to draw some reasoned conclusions and develop a program for the future. We believe our hypotheses are reasonable, although they are certainly open to disagreement, and that time is likely in its wonted way to develop conditions no one could have foreseen.

Nevertheless, certain conclusions have been drawn from the study which can be summarized as follows. The justification for these conclusions and an extended discussion of the reasoning which supports them, as well as statistical and tabulated information, are contained in the following sections of the Report.

1. The capital requirements of the rural electric program will continue to be large, notwithstanding the dramatic reduction of the rate of growth in energy demand nationwide. Rural electric demand is expected to grow, although at less than historic rates. The requirements for additional capital will be strong in all sectors of the program, but particularly for power supply systems. Based upon assumptions as to load growth and inflation rates utilized in this Report, distribution cooperatives will require \$12.5 billion of funding to 1990, while the G&Ts will require commitments in excess of \$49 billion. (Part III)
2. The support of the REA has been essential to the success of rural electrification and has been crucial in two respects: (a) in lowering

the overall cost of capital, and (b) in assuring access to capital for both the distribution and power supply cooperatives who were otherwise unqualified for funding in the capital markets. The REA guarantee-FFB funding program has proven, in our judgment, to be a unique and irreplaceable capital resource for G&T systems, and essential to the recent very dramatic expansion of the G&Ts. It is equally important, however, to stress that even the limited amount of private G&T financing that has been obtained to date could not have been obtained without strong investor confidence that the REA would continue to play a dominant role in financing power supply systems, and that the administrative involvement of the REA in rural electric systems could be fully relied upon by lenders in the private sector. FFB access has provided a significant interest and transaction cost advantage to the G&Ts in comparison to funding of the guarantee in the private capital markets. Of much greater importance has been the guarantee itself, which assures funding flexibility and availability of long-term financing regardless of market conditions. (Part IV)

3. The supplemental financing provided by CFC, and to a lesser extent by the Banks for Cooperatives and other lenders, has been successfully integrated into the basic REA program and has enlarged the supply of capital at some higher but still acceptable cost of money. (Part IV)
4. CFC is capable of enlarging its role in providing supplemental financing for distribution cooperatives to the extent necessary. (Part V-B)

5. G&T systems have the potential for expanding their access to private capital, but within the context of a strong continuing REA guarantee program. The Committee on Objectives and Planning projects a total of \$49.3 billion of capital commitments for construction programs through 1990. In our judgment, even the fullest possible exploitation of available private financing alternatives would fall short of meeting these requirements. It is particularly important to stress that even the perception of substantially diminishing REA support would limit the full utilization of available private market alternatives—that is to say, that access to the private market will be maximized if a strong ongoing REA financial and administrative commitment is assured. Given this assurance, we believe that G&T systems have several alternatives for expanding their access to private capital. (Part V-A)

6. Individual G&Ts have the capability of entering the market independently if they meet the credit standards of investors, particularly for interest coverage and capitalization ratios. There is an entrance price until the credit becomes familiar, and there will always be periods of market rejection of weaker credits. The poorer G&T credits and those with large start-up and expansion programs will have greater difficulty and may even face denial. Separate financing could set in motion intramural competitive forces which could result in increased overall costs to consumers. (Part V)

7. CFC can play a vital role in G&T financing while continuing its traditional role with its distribution members. Our Report examines the relative merits of collective action through a new financing vehicle or through CFC directly. CFC has effectively fulfilled not only its original mission of supplementing direct REA loans to distribution members, but also the added one of greatly expanding and diversifying the range of financing services it provides to its distribution and G&T members alike. We believe that CFC, with proper equity support, has a substantial ability to further expand its distribution lending and its guarantee program over time. However, in augmenting CFC's participation in providing credit to G&Ts, it is important that it be done in a manner which economizes on the use of CFC's credit capacity, which has finite limits. (Part V)

8. Collective action holds the best promise for effective private capital market access. Of the financing options we analyzed, we believe the greatest efficiency of access to the private capital markets can be obtained through a collective financing vehicle distinct from but sharing many similar concepts with CFC, and relying in varying degrees on CFC's credit strength and acknowledged favorable market acceptance during its development and operation. We believe that the pooling of individual G&T credits would provide a stronger debt rating for the securities of this vehicle than most G&T systems could command independently, and would provide more effective leveraging of the equity capital resources of G&T members and their consumers than would independent access, thereby implying lower costs. This

could be accomplished by forming a new financing entity such as the Power Supply Financing Cooperative outlined in Part V-D of this Report. It should be possible for CFC to provide management services for this new financing entity so that no significant new administrative and operational staff requirements would be imposed. While it would take some time to implement such a program, it would gradually be able to attract significant funding. The concept of strength through unity has served the rural electrification program well, and we believe the rationale that led to the founding of CFC thirteen years ago still applies today.

9. Other suggested financing options are less desirable, or less feasible, than those discussed above:
 - (a) Agency Status. While the designation of CFC, or a similar organization, as a federal agency would provide undeniable benefits in terms of favorable entry to the capital markets at rates only slightly above the cost of present FFB funding, establishment of such status runs counter to reducing government involvement. Creation of agency status would require legislation and, at least initially, direct government credit support. Market acceptance of a new agency without direct government credit support would only be gradual, thus limiting the amount of funding obtainable and imposing higher required interest rates than for established agencies. Nor would agency status assure the quantity of long-term funding presently available through the REA guarantee-FFB funding program. (Part V-C)

- (b) Credit Insurance. Credit insurance is an unproven form of credit support in the taxable market. We are unable to assess its cost, or the amount of credit that such a mechanism could provide. However, this option, which is currently in a developmental stage, could prove to be a method of minimizing credit risks for investors and should be further explored. (Part V-C)
 - (c) Banks for Cooperatives. Under existing policies, the Banks for Cooperatives have done very little co-financing with other financing entities. In addition, the Banks for Cooperatives have largely limited their financing of G&Ts to the funding of REA guarantees already in place. Even if the Banks for Cooperatives exhibited more active involvement in financing power supply systems without a federal guarantee, BC system lending restrictions and eligibility requirements limit the amounts of capital available from this source. (Parts IV-C and V-C)
 - (d) Other Alternatives. Lease financing, tax-exempt financing, project financing, and a variety of different types of securities--such as commercial paper and bank credit--provide a variety of valid but limited alternatives. (Part IV)
10. Any transfer of a major part of G&T financing requirements from the present government program to direct private market funding would place the cooperative sector in direct competition with the investor-owned utilities for a limited supply of long-term debt. As a result,

either some debt demand could go unfilled, or interest rates could be driven up (or both), to the detriment of all utility consumers. (Part V-A)

11. Regardless of the extent to which CFC expands its responsibility for G&T funding, it should strengthen its equity base by a program extending the duration of the subscription CTC's and lowering the cost of the loan CTC's. (Part V-B)

The present federal program, while not perfect, is a satisfactory one. Any reduction in its size and scope will impose significant additional costs upon ultimate consumers while potentially restricting the flow of long-term capital to rural electric cooperatives. A sudden elimination of the federal program would have a dramatic adverse impact; a more gradual, and limited, reduction can probably be absorbed over an extended period of time.

Following is a ranking of the primary long-term financing alternatives for G&Ts. While we have provided brief commentaries, these rankings should be considered within the context of the entire report. The interest rates used were those in effect in November, 1982 and it should be noted that the spread relationships among the various types of obligations will vary with the general level of interest rates.

(The table attachment is held in the committee files.)

STATEMENT OF DONALD E. SMITH
CHIEF ECONOMIST, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
Before the
SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT
COMMITTEE ON AGRICULTURE
UNITED STATES HOUSE OF REPRESENTATIVES

October 5, 1983

My name is Donald E. Smith. I have served as the economist for the National Rural Electric Cooperative Association since 1969. The subject of my statement is the federal assistance provided to all electric utility sectors, whether cooperatively, publicly, or investor-owned. It is a matter of importance which we feel deserves the attention and understanding of members of this important committee.

You are all aware of the assistance to the rural electric systems through the provision of REA insured loans at favorable interest rates. This enables the rural electric cooperatives to distribute electricity to the most sparsely settled rural areas of the nation. In fact, the co-ops average 4.7 consumers per mile compared to 35.8 for investor-owned utilities (IOUs) and receive \$3,370 per mile compared to \$42,007 for IOUs. (See Table II.)

The federal assistance to rural electric systems may be calculated as the difference between the REA lending rate (5%) and the government's borrowing cost (13% in FY 1982) times the lending level (\$850 million), or \$68 million. Adding \$15 million for REA staff and administrative expenses for the electric program raises the total "cost" to \$83

million. Since the REA loan guarantees are funded by non-REA lenders on a market rate plus cost basis, they are without cost to the government.^{1/}

Federal assistance to publicly-owned utilities arises indirectly through their authority to issue tax-exempt securities for all their financing requirements. The interest income on such securities is exempted from federal income taxation, thus enabling the governmental utilities to obtain capital at substantially lower interest rates than taxable bonds.

The resulting revenue loss to the Treasury or "tax expenditure" as calculated by the OMB amounts to an estimated \$331 million.^{2/} This level of federal assistance to publicly-owned electric utilities is completely appropriate and justified, enabling the municipal utilities to provide essential electric service at affordable rates.

The investor-owned utilities are the largest sector of the industry and are the recipients of the largest levels of federal assistance. As regulated utilities, their rates are set by commissions to be adequate to cover all costs, including the payment of federal income taxes. These federal taxes, once collected, are largely retained by the IOUs due to the availability of special tax benefits. In 1981, the IOUs retained \$1.4 billion attributable to the investment tax credit. The utilities retained an additional \$2.2 billion (net) due to accelerated depreciation. Thus, their tax subsidy totaled \$3.6 billion.

^{1/} The REA loan guarantees are typically funded by the Federal Financing Bank (FFB) at the market interest rate plus .125% which exceeds the actual costs incurred by the FFB, plus an additional charge to cover REA administrative expenses. No defaults or other losses whatsoever have been experienced on REA loan guarantees.

^{2/} The tax expenditure for publicly-owned electric utilities may be calculated by the annual amount of tax-exempt financing times the income of comparably-rated taxable securities times an average marginal tax rate times the life of the securities (discounted to a "present value"). See OMB's Special Analysis of the U.S. Budget.

A recent study by the Congressional Budget Office (CBO), a research agency of the U.S. Congress, is entitled "Promoting Efficiency in the Electric Utility Sector." The report's chapter on Tax Subsidization states that "tax subsidies carry the same advantages as a cash subsidy." It reports that:

A fundamental problem with tax subsidization of electric utilities has been the limited federal tax burden borne by them. In 1979 and 1980, for example, utilities paid only \$743.5 million and \$1.24 billion, respectively, in federal taxes, or about one-fourth of their book tax rates. In fact, 51 (or 25 percent) of 203 private electric utilities paid no federal taxes in 1980.^{1/}

According to tax specialist Donald Kiefer of the Congressional Research Service, the IOUs' expanded tax benefits under ERTA and TEFRA will enable them to retain the entire amount of their tax collections, thereby remitting no revenue to the Treasury whatsoever. Kiefer estimates that the IOUs' tax subsidies will increase by \$725 million in 1983, \$925 million in 1984, and \$1,157 million in 1985.^{2/} The outstanding tax benefits that have been provided to the IOUs totals \$25 billion, according to the Dept. of Energy.^{3/}

^{1/} Promoting Efficiency in the Electric Utility Sector, Congressional Budget Office, November 1982, p. 43.

^{2/} Ibid, p. 44.

^{3/} DOE, Statistics of Privately-Owned Electric Utilities, 1981.

One additional tax benefit provided to IOUs in 1981 by ERTA was dividend reinvestment, whereby stockholders may take up to \$1,500 (per couple) in new stock annually in lieu of cash dividends and thereby pay no taxes. This benefit is providing the IOUs with common stock capital at an annual rate of \$2.6 billion, representing about 50 percent of their stock requirements.^{1/} The cost to the Treasury of this new benefit (provided to electric and gas utilities exclusively) has been estimated by the Treasury to be \$416 million during the current fiscal year. This tax expenditure of the dividend reinvestment benefit is in addition to that of the investment tax credit and accelerated depreciation, so that the total federal assistance to investor-owned utilities exceeds \$4 billion annually.

It is important to point out to members of the committee that this Administration has proposed and supported legislation greatly expanding the tax assistance provided to the investor-owned utilities. They have done so in response to the serious difficulties which have beset the utilities in recent years. The combination of rapidly escalating costs and rates, imposition of new environmental requirements, declining energy use due to price elasticity and conservation, and other significant factors have resulted in dire financial consequences on all electric utilities. The response of the Administration and the Congress in providing additional federal assistance to the investor-owned utilities is appropriate and deserving.

^{1/} Energy Daily, (July 14, 1983); Electric Utility Week (March 7, 1983).

We have great difficulty, however, in understanding the increased assistance to IOUs on the one hand, and the Administration's persistent efforts to reduce drastically the minimal assistance provided to the rural electric systems on the other. For example, for the current fiscal year the Administration proposed REA insured loan reductions amounting to \$350 million or 41 percent. Nor has the Administration supported the proposed legislation (H.R. 3050) to preserve and enhance the RE&TRF and the REA lending program. Its recognition of the financial dilemma of the IOUs serving the densely settled urban areas and total disregard of the greater need of utilities serving the most sparsely settled three-fourths of the nation's land areas is particularly baffling.

In conclusion, Mr. Chairman, we believe that it is of critical importance for the Congress and public to realize that the three electric utility sectors each receive and require federal assistance.

This Administration recommended and the Congress approved legislation greatly expanding the federal assistance to the investor-owned utilities. The federal assistance to the investor-owned and publicly-owned utilities far exceeds that to the cooperatively-owned utilities (See Table I), despite the co-ops' relatively adverse operating and financial characteristics. (See Table II.)

Passage of the proposed legislation will help redress this inequity in federal assistance by preserving a viable REA financing program to ensure the availability of reliable and affordable electric service throughout rural America.

TABLE I
FEDERAL ASSISTANCE TO ELECTRIC UTILITIES

	<u>Federal Assistance</u>	
	<u>1981</u> (\$Millions)	<u>Per Consumer</u>
Rural Electric Cooperatives	83	\$8.91
Publicly-Owned Utilities	331	\$40.45
Investor-Owned Utilities		
Investment Tax Credit	1,415	
Accelerated Depreciation	2,168	
Dividend Reinvestment	130	
TOTAL	3,713	\$51.64

Sources: REA Annual Statistical Report, Dept. of Energy Statistics of Publicly-Owned, Privately-Owned Electric Utilities 1981 Annual, U.S. Treasury.

TABLE IIFINANCIAL & OPERATING COMPARISONS OF ELECTRIC UTILITIES

	<u>Rural Electric Cooperatives</u>	<u>Publicly-Owned Utilities</u>	<u>Investor-Owned Utilities</u>
Consumers per Mile	4.7	77.5	35.8
Revenue per Mile	\$3,370	\$68,128	\$42,007
Investment per Consumer	\$1,577	\$828	\$902
Miles of Line (000)	2,010	NA	169
Equity total %	19.3	23.4	38.1
G&T %	2.8		
Internally-generated financing, % of total	12	25	55
Rate of Return	5.9*	5.0	13.7
TIER (total)	1.8	1.8	2.3

* Distribution Systems

Sources: REA Annual Statistical Report, Dept. of Energy Statistics of Publicly-Owned, Privately-Owned Electric Utilities 1981 Annual, Electrical World Annual Statistical Report.

Statement
of
Gene L. Swackhamer,
President of the
Farm Credit Banks of Baltimore

Mr. Chairman, members of the Subcommittee on Conservation, Credit, and Rural Development.

I am Gene Swackhamer, President of the Farm Credit Banks of Baltimore, a lending institution serving farmers, ranchers, fishermen, rural home owners, and agricultural cooperatives in Maryland, Pennsylvania, Delaware, Virginia, West Virginia, and Puerto Rico. At the end of 1982, the Farm Credit Banks of Baltimore had loans outstanding to 62,675 farmers and co-operatives in the amount of \$3.1 billion.

Daniel Webster wrote, "When tillage begins, other arts follow. The farmers, therefore, are the founders of human civilization." Those words are as true today as they were over a hundred years ago when Webster wrote them, but our farmers and ranchers of today and the organizations that serve them must exist in an increasingly more complex and fast changing world. Not only has agriculture and rural America been changing dramatically to keep pace with changing times, but also the organizations serving agriculture and rural America have been changing to better meet the needs of our "founders of human civilization." I am here today to talk to you about some of those changes, and some changes that need to be made.

We now recognize that agriculture in this nation includes not only the farmers and ranchers who produce the basic agricultural inputs, but also the processors, transporters, marketers and farm suppliers as well. In 1980 this group accounted for \$533 billion, or a 20% share, of our Gross National Product; 23% of employment; and a 20% share of export earnings.

Agriculture and its related activities represent a major sector of the American economy. Its scope is impressive. We in the Farm Credit System and our friends in the rural utilities are committed to serving this vital segment of our economy. We in Farm Credit recognize that farming and ranching are truly like no other business activities, and we view the Farm Credit System as having the wherewithal to support agriculture and its related services in a changing environment.

The Federal Land Banks were established in 1916 to meet the demand for rural/farm mortgage money. In 1923, the Federal Intermediate Credit Banks were established to provide short term (production) credit by discounting the notes of other lenders. Because of the FICBs' limited success in discounting, the production Credit Associations were created in 1933 to provide the farmer/borrower direct access to the FICB. It was also in 1933 that the Banks for Cooperatives were created. Each of the three components of the Farm Credit System was established to meet a credit need for farmers, ranchers, and their service entities (cooperatives) that was not being met. The System in place today is the result of an evolutionary process, and has withstood the test of time.

As a part of the nationwide Farm Credit System, consisting of 37 Banks and nearly 1,000 local lending associations, our 18,000 employees are proud of the fact that they are serving nearly half of all of the farmers in the U.S. and two-thirds of their farmer cooperatives. At the end of 1982, the System had loans outstanding totaling \$80.4 billion to its numerous and varied rural and agricultural customers.

The System gathers most of its funds for lending through the sale of securities of The Farm Credit Banks to the investing public. Sales of securities are handled by The Federal Farm Credit Banks Funding Corporation headquartered in New York City. In 1982, some 150 securities dealers assisted the Funding Corporation in placing our bonds.

I am particularly interested today in bringing to your attention the involvement and commitment of the Banks for Cooperatives in rural electric lending. The rural electric program and the Banks for Cooperatives were both organized at about the same time. Initially, the financial requirements of the rural utilities were taken care of almost exclusively by the Rural Electrification Administration. The BC System first became involved in rural electric lending in a very minor way in the 1940s, but it wasn't until after passage of the 1971 Farm Credit Act that the BC System began to gain experience and develop significant lending relationships with rural utility cooperatives. This occurred primarily because the Rural Electrification Administration (REA) began to require rural electric cooperatives to find part of their financing elsewhere, and because the BC System has a strong commitment to serving rural cooperatives. Additionally, with the lower eligibility requirements, many BCs saw rural electric cooperative lending as a way to diversify their loan portfolios for risk management purposes.

Today the rural utilities market is well served by two supplemental lenders: the Banks for Cooperatives and the National Rural Utilities Cooperative Finance Corporation (CFC). From the beginning the BCs have tried to develop both the large borrower G&T market as well as the smaller distribution cooperative market. CFC has concentrated its direct lending activity primarily to distribution cooperatives.

The BCs have much to offer rural utilities -- a large funding capacity, favorable interest rates, and service oriented cooperative philosophies. Many BCs have also made long term organizational commitments to serve rural utilities.

In the more than ten years which have transpired since passage of the 1971 Act, rural utility cooperatives have become an integral part of the BCs' agribusiness cooperative membership. They have been a part of the

System's normal loan growth, causing no disruption in System funding. Also, the BC System's loan volume to rural utility cooperatives has significantly contributed to the stability, diversity, and quality of the BC System's overall loan portfolio. From the perspective of the rural utility cooperatives, the System has been a dependable source of competitively priced supplemental loan funds. BC loans have, in some cases, resulted in lower interest costs to utility cooperatives and, thus, indirectly have favorably affected rates paid by the consumer patron.

Today, nine of our twelve District Banks for Cooperatives have loans and/or commitments to nearly 200 rural utility cooperatives totaling in excess of \$2 billion. While this represents only a small portion of the Farm Credit System's loan volume and only a small number of its cooperative borrowers, I believe it is evident that our Banks are in rural utility lending to stay, and are making every effort to provide funds and services that will meet the needs of borrowers for the future.

While the Banks for Cooperatives work with telephone, distribution, and generation and transmission cooperatives (G&Ts), the lion's share of our rural utility loans are made to the G&Ts. We recognize that power usage has declined substantially in recent years and probably will not increase appreciably in the foreseeable future. The demand for generation and transmission facilities may maintain a level posture or increase moderately, which will result in very few transactions relating to new construction. Our Banks recognize this short term trend, but expect an upswing in demand for new facilities and credit during the last half of this decade.

G&Ts are very capital intensive projects, so our involvement in this area has primarily been in the role of supplemental lender. For instance, we do front-end financing, bridge financing, and some projects themselves in participation or partnership with other sources of credit.

Several of the factors that limit our role in rural utility lending include:

- 1) The eligibility of the entity seeking credit;
- 2) BC System lending limits; and
- 3) The creditworthiness of the cooperative seeking credit.

The BCs are required by law to provide loan funds only to eligible cooperatives. Current law provides that for a cooperative to be eligible for a BC loan, the number of farmer-members must be at least 60%, or higher if so decided by any district board. We believe this requirement effectively eliminates a substantial number of rural utilities from BC borrowing.

A second factor affecting the extent to which BCs can become involved in rural utility lending is our BC System lending limits. The lending limit for any term loan to a single credit risk is 25% of the BC System's net worth, or 50% if the loan carries a full faith government guarantee. Considering that the present net worth of the BC system is approximately \$1.2 billion, our maximum line of credit to a single guaranteed borrower would be \$600 million. This lending limit will not be a barrier to providing loans to distribution cooperatives, but it does have a limiting effect on loans to G&Ts.

A third factor affecting the BCs' ability to lend to rural utilities is the question of creditworthiness of potential borrowers. Many of our G&T systems are fairly young systems and have fairly low equities, about 1 to 5% of equity against total assets. From our perspective, these low ratios indicate a continuing need for government guarantees, which most of our term loans carry. I'll have more to say about the loan guarantees in a minute.

The point I'm making, Mr. Chairman, is that we want you to know, and we want REA and the rural utilities to know, that within the limits just outlined, the Banks for Cooperatives are a very willing participant in the financing of rural utilities. We will continue to work with our rural utility systems. They are important to us, not only from a lending standpoint, but also from the standpoint of helping us to improve the quality of life for our farmers and ranchers.

I would now like to comment on the specific need for H.R. 3050.

When the REA program was created nearly 50 years ago, rural electric cooperatives were established to operate in areas where other utilities either could not or would not serve. In many instances, such is still the case today. In large measure, rural utility cooperatives serve thinly populated territories. These rural utility systems financed by REA operate approximately 50% of all distribution lines in the United States, but serve only 10% of the nation's consumers. The average rural utility cooperative's investment per consumer is 162% of the average power company's investment. These factors and others, combined with higher utility construction and operating costs, have contributed to the difficult financial and economic conditions in which electric cooperatives now operate.

H.R. 3050 is designed to preserve and maintain the REA loan and loan guarantee program so vital to the continued financing of rural utility cooperatives. We in the Bank for Cooperatives System are supportive of the provisions of H.R. 3050. As I indicated earlier in my testimony, both the Farm Credit System and our rural utility cooperatives are being forced to do business in an increasingly complex and quickly changing environment. The amendments to the REA Act contained in H.R. 3050 provide the means for the BC System to continue to develop in its role as a provider of supplemental credit to rural utility cooperatives. Additionally, this legislation preserves the mutually beneficial relationship that has developed over the years between the Rural Electrification Administration, the rural utility cooperatives, and the BC System.

By the end of 1982, System loans outstanding to rural utilities amounted to \$1.316 billion. This loan volume has been consistent in its growth, and the REA guarantee program has provided the System its primary entree into REC financing. The lending programs developed by the BC System were developed to complement the dominant lending roles provided by REA and the Federal Financing Bank. There are some who would argue, and I believe rightfully so, that if it were not for the continued involvement of the Rural Electrification Administration in the rural utilities lending program, the Banks for Cooperatives' lending for rural utilities would be greatly diminished. I am pleased, therefore, to note that H.R. 3050 both recognizes and preserves the role of REA in rural utilities cooperatives financing.

While we in the BC System are generally supportive of the provisions of H.R. 3050, we would like to take special note of that provision relating to lien subordination and accommodation. We are pleased that H.R. 3050 clarifies the authority for REA to subordinate its first lien on the property and revenue of its borrowers. For years, REA was the exclusive lender to rural utility cooperatives, and its standard mortgage contracts naturally included a first or priority lien on the assets of its borrowers. However, as newer supplemental sources of financing were being developed, a perhaps inevitable conflict has developed between the government's desire to reduce rural electric borrowers' reliance on REA and its continued reluctance to diminish its security interests in the assets of its borrowers. We believe that the clarification of the authority for REA to either subordinate or accommodate the security interest of supplemental lenders as ourselves would more than likely encourage an increased flow of investment capital.

Mr. Chairman, I am pleased to have had this opportunity to appear before you this morning, and to provide you with information on the role of the Banks for Cooperatives in rural utilities lending, and how we in the BC System believe that role will be both preserved and enhanced by the passage of H.R. 3050. I will be pleased to answer any questions that either you or other members of the Subcommittee may have at this time.



Cooperative League
of the USA

A Voice for America's Cooperatives

TESTIMONY OF THOMAS G. KRAJEWSKI

Vice President for
Agricultural Cooperatives

COOPERATIVE LEAGUE OF THE USA

SUBCOMMITTEE ON CONSERVATION, CREDIT,
AND RURAL DEVELOPMENT OF HOUSE AGRICULTURE COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

OCTOBER 5, 1983

828 L Street, N.W., Suite 1100 • Washington, D.C. 20036 • (202) 872-0550 • Cable: CLUSA

The problem now faced by the REA Revolving Fund is that money they borrow costs too much. Borrowing at market rates while making loans to rural electric cooperatives at 5-6 percent interest rates, is draining the Fund. The Fund is designed to make new loans with loan repayments. Interest expense for the Fund will soon begin to exceed the interest income from loan repayments late in this decade. This would force the REA to dip into the Rural Electrification Revolving Fund principal to meet loan obligations.

National Rural Electric Cooperative Association has presented Congress with a well-developed, responsible proposal to effectively deal with the potential problem of the Fund's insolvency. NRECA recommends that insured loan interest rates be increased about 2 percent with adjustments as needed. Once approved, periodic adjustments would only affect new loans at that time. The principal payment now obligated to Treasury in 1993 should instead be paid into the Revolving Fund.

By having the principal repayed to the Fund, Congress would not need to appropriate money directly for the Fund as new high-interest borrowing would not be necessary. This would cause no change in the U.S. Budget as these funds have been appropriated and expended. These various changes would ensure continued solvency of the Revolving Fund.

The Cooperative League joins all current congressional supporters, and the National Telephone Cooperative Association in supporting National

Electricity brought many changes to rural America with one of the larger impacts seen in the explosive growth of agricultural production. Today, American consumers along with most of the world rely on this generous supply of food produced by our farmers served by rural electric cooperatives.

Approximately 50 years later, the Rural Electrification Administration now makes loans to over 1000 non-profit consumer-owned rural electric systems serving 25 million people in 46 states. Averaging 4.6 consumers per line mile compared to 35.8 users per commercial line, rural electric cooperatives are facing rapidly escalating costs that are reflected in higher consumer electric rates.

The Revolving Fund is the source of insured loans supplying most of the capital need by rural electric distributions systems. As load predictions are increasingly difficult to forecast, rural electrics have started to build their own generating systems as wholesale power distributors have not been able to satisfy supply demands. The costs of building these plants are extremely high especially when the cost must be borne by thinly populated areas.

REA was first established in order to help the new and struggling rural electric cooperatives bring electricity to their rural member-owners. Now the REA Revolving Fund needs assistance in order to continue helping rural electric and telephone cooperatives who are still beset by high costs and are still determined to serve low-density areas regardless of the costs.

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Rural Electric Cooperative Association's proposed legislation to help Rural Electrification Administration Revolving Fund regain its self-sufficient status without cost to the U.S. Treasury. REA is still needed to assist cooperatives which maintain 50 percent of our nation's electric lines but account for less than 10 percent of total electricity sales. To retain equal status as benefactors of electricity at reasonable rates, rural America requires preservation of an adequate lending program as is found under the REA Revolving Fund.

FRANK McCLOSKEY
5TH DISTRICT, INDIANA

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ARMED SERVICES COMMITTEE

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RESEARCH AND DEVELOPMENT
MILITARY PERSONNEL AND COMPENSATION

SMALL BUSINESS COMMITTEE

SUBCOMMITTEE:
ANTITRUST AND RESTRAINT OF TRADE ACTIVITIES

Congress of the United States
House of Representatives
Washington, D.C. 20515

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October 5, 1983

Honorable Ed Jones, Chairman
House Agriculture Subcommittee
on Conservation, Credit and
Rural Development
1301 Longworth House Office Building
Washington, D. C.

Dear Mr. Chairman:

Because your Subcommittee is now holding hearings on H.R. 3050, the Rural Electrification and Telephone Self-Sufficiency Act, I hope you will be able to include a copy of my statement in further support of this bill in the hearing record.

I know my constituents who depend on reliable rural telephone service appreciate very much your work on this important issue. Thank you for your leadership in this vital area of rural development.

Sincerely,

Frank McCloskey
Frank McCloskey, MC

FM/cda

Congressman Frank McCloskey/Agriculture Subcommittee of Conservation, Credit and Rural Development hearings on H.R. 3050 (LJRB 1302)

Mr. Chairman, I appreciate the chance to say a few words today in support of H.R. 3050, The Rural Electrification and Telephone Self-Sufficiency Act will make necessary changes /of user-owned cooperatives/ in the present program which has provided universal telephone service to rural areas. The fact is that through enactment of H.R. 3050 we are supporting a user owned utility which works. Since the 1930's nearly 1,000 of these small economic "democracies" have been constructed soundly and operated prudently providing serve to 25 million rural Americans in 46 states. Given the prevailing high interest rates, it has now become essential for the Rural Electrification Administration to set loan rates for a return which will insure the solvency of the rural electric telephone revolving fund. The fact that not one user-owned rural telephone cooperative has defaulted on such financing underscores the logic of the changes in the program which H.R. 3050 seeks to accomplish. Over 160 of our colleagues have cosponsored this legislation. I hope the Committee can move with all deliberate speed and assure the Chairman of my own continued support for this legislation.

Testimony Submitted by Congressman James F. McNulty, Jr.
Subcommittee on Conservation, Credit and Rural Development
House Committee on Agriculture
October 5, 1983

Mr. Chairman and members of the committee, I appreciate your willingness to allow me to submit this testimony. I am a relative newcomer to the Congress, having been elected last year as representative of a new and largely rural district in southeastern Arizona.

My knowledge of rural electrification is derived from 32 years of service as general counsel to the Sulphur Springs Valley Electric Cooperative, which was founded by my Bisbee, Arizona, law partner some 46 years ago, and as general counsel to the Arizona Electric Power Cooperative, for which I was original incorporator 24 years ago. Both cooperatives serve electrical customers from the small towns, cattle ranches and diverse farms of rural southeastern Arizona.

When the Rural Electrification Act was first implemented in 1936, it had as its goal the extension of electrical service to all rural areas of the nation. The establishment in 1973 of the Rural Electrification and Telephone Revolving Fund was a reaffirmation of that goal by the Congress. Through the years, electric and telephone services have been extended to most regions of the United States, and the performance of the Revolving Fund over the past 10 years has brought services to more and more areas. Today, we are at a point where our final goal -- nationwide service -- is in sight.

But today the Rural Electrification and Telephone Revolving Fund is in trouble. The fund lends money at low interest rates to cooperatives and other institutions, which install electric and telephone services to the rural communities. These rates are fixed by law, and have remained low -- always below 5 percent -- throughout the past few years, as market interest rates rose to unprecedented heights. The rate presently stands at 5 percent. When the Fund is unable to balance its income with its outlays it can, as authorized by its charter, borrow from the U.S. Treasury to make up the difference. That borrowing takes the form of sales of Certificates of Beneficial Ownership

REA testimony 2-2-2

(CBOs) to the Federal Financing Bank. The CBOs reflect market rates of interest, which have ranged from 10 to 15 percent in recent years. The difference between the CBO rates and the rates the Fund can charge its customers is the amount that must be met by the resources of the Fund. To date, they have been adequate. But they cannot much longer endure interest rate discrepancies of as much as 10 points, and the Fund faces eventual collapse under the current system.

The most important provision of the bill before this committee today would provide for the long-term solvency of the Revolving Fund, by offering a fairly simple solution to correct the discrepancy between lending and borrowing rates. It would allow the Administrator of the Rural Electrification Administration to set the interest rate on new loans at a level necessary to cover the interest expense on new CBOs. It will give the Fund a fair chance to correct its impending deficit.

This bill is particularly commendable because it allows the Fund the opportunity to seek a voluntary solution to its own financial problem. There are no Federal handouts involved here, simply an initiative to allow the Fund to achieve self-sufficiency on its own. We should regard that with favor.

The establishment of electric and telephone cooperatives has resulted in the extension of electric and phone services to most parts of this nation. We all would like to see the day when every person in this land can have quality, affordable electrical and phone service. We are almost there. This legislation will ensure that we do not fall back on our commitment to that important goal, and that we continue to strive toward that goal without burdening the Federal budget with additional subsidies.

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Hon. G. V. (Sonny) Montgomery
Subcommittee on Conservation, Credit and Rural Development
Statement on H.R. 3050
October 6, 1983

Mr. Chairman, I want to commend this Subcommittee for holding these hearings and to thank you for the opportunity to submit my statement in support of H.R. 3050, the Rural Electrification and Telephone Revolving Fund Self Sufficiency Act of 1983.

I am a co-sponsor of this legislation. I signed onto the bill not because of pressure from back home. Rather I joined because I believe that a sound, long-term Rural Electric Administration financing program is essential to the continuing efforts to provide reasonable, reliable and efficient service to rural communities. This legislation would protect the solvency of the REA revolving fund.

When this fund was set up in 1973, projections were made to ensure that the income would keep pace with expenses in the fund. But the Arab oil embargo of 1973 and the effects it had on our economy have created problems for the revolving fund. Inflation, coupled with high interest rates have created an imbalance, and if action is not taken quickly, interest expense will exceed interest income by 1986 or 1987.

Passage of this bill will allow the interest rate to rise above the current 5% on insured loans. Eight billion dollars worth of assets now in the fund would be converted

Rep. G. V. (Sonny) Montgomery
Page Two

to permanent capital, rather than allowing the transfer of these funds to the Treasury in 1993. Additionally, the bill maintains the current 70-30% ratio of insured loans to outside capital.

I see this legislation as essential. The only alternatives I see to the provisions of H.R. 3050 are massive federal appropriations, which I think most of us would find highly unacceptable, or open money market borrowing. Neither of these would be as desirable as the provisions of the bill before you today.

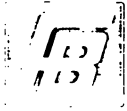
Since the Rural Electric Administration was created in 1936, it has done a tremendous job of helping bring electric and telephone service to rural America. This is especially important to a rural state like my own.

Based on the first hand observations I have made with REA, I can testify that the Administration must be allowed to continue providing these services, which have improved the quality of life for millions of people over the past 47 years. That is why I am supportive of this legislation and request that this Subcommittee act favorably to preserve the integrity of the rural electrification programs.

Thank you.

ALABAMA FARM BUREAU FEDERATION

P. O. Box 11000/Montgomery, Alabama 36198/(205) 288-3900



GOODWIN L. MYRICK, President

October 19, 1983

The Honorable Bill Nichols
U. S. House of Representatives
2407 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Nichols:

The widespread delivery of electric power to remote and rural areas of this nation has changed the lives of millions of Americans. The fact that it has been accomplished by user-owned cooperatives makes the accomplishment all the more significant. Construction of the lines to connect rural cooperative members to the power distribution system has in the past been financed by loans from a revolving fund in the Federal Rural Electrification Administration (REA). The fund is authorized to borrow from the U.S. Treasury at the going rates of interest. Agency assets and the pledge to repay previous loans have provided security for Treasury Loans to the revolving fund. Interest rates on loans from the revolving fund are set by law at 5% with a 2% rate permitted in hardship cases. In recent years inflation in interest rates has exceeded the repayment rates. This has created a condition where repayment dollars have not kept pace with payment requirements, and prompted rural electric cooperatives to conduct a study of the situation and to seek workable solutions.

It was concluded that several adjustments would have to be made to maintain the integrity of the system. Legislation has now been introduced which will address the problem and which should enable the rural electric cooperatives to continue to expand the system as needed.

Changes in the system would allow the administrator of REA to adjust interest on revolving fund loans. It would also provide for the Treasury obligations which now comprise the assets of the fund to be transferred to the revolving fund as permanent capital. Loans from the fund would continue to be fully repayable with interest and future loans would be made from the assets of the revolving fund. The legislation would also authorize future refinancing of the revolving fund borrowings from the Treasury.

This legislation is contained in two companion bills, S.1300 and H.R.3050. The legislation is supported by the Alabama Farm Bureau Federation and we respectfully request that you support them.

Sincerely,

Goodwin Myrick
Goodwin Myrick
President

SF

Over Fifty Years of Service to the Farm and Rural Families of Alabama

DEPOSIT

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